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On the cover
Wounded, tetchy and less effective than it should be, America is still the power that counts: leader

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Politics this week

Jun 28th 2007
From The Economist print edition

Reuters

The new leader of the Labour Party, Gordon Brown, the former chancellor of the exchequer, took over from Tony Blair as **Britain's** prime minister. Ahead of his cabinet selection, Mr Brown, speaking in Downing Street, said: “Let the work of change begin.” See article

On the day of his resignation **Tony Blair** was appointed roving envoy for the “quartet” of countries and clubs—the United States, the United Nations, the European Union and Russia—seeking to make peace between Israelis and Palestinians. The appointment got mixed reactions.

At a summit in Brussels, the **European Union** agreed to the outline of a new treaty to replace the draft constitution that was rejected two years ago by Dutch and French voters. The treaty's critics complained about, and its supporters celebrated, the inclusion of much of the substance of the constitution. But EU leaders from Britain, France, the Netherlands and Poland all insisted it was changed enough to justify their decision not to hold referendums. Only Ireland is likely to put the treaty, when it is drafted later this year, to a vote. See article

Shortly after the summit deal on the treaty, France blocked the opening of a chapter in **Turkey's** negotiations on membership of the European Union. The French president, Nicolas Sarkozy, insists that Turkey has no place in the EU. Two other chapters in the negotiations were opened, however.

In a report on new European Union members, the European Commission criticised **Romania** and **Bulgaria**, which joined this year, for doing too little to fight corruption. The commission said that if they did not do more next year it would recommend sanctions against the two countries.

Nuclear reaction

Inspectors from the International Atomic Energy Agency visited **North Korea** for the first time since the IAEA was expelled from the country in 2002. South Korea later announced it would resume food aid to the North. This followed North Korea's receipt of some $25m that had been frozen in a bank in Macau. The deal reached in February under which North Korea agreed to shut down its nuclear reactor at Yongbyon had been stalled.

Nguyen Minh Triet, the president of **Vietnam**, paid a visit to America, the first by a Vietnamese head of state. He signed a trade and investment pact, and met his American counterpart. George Bush raised concerns about Vietnam's treatment of political dissidents.

AP

Hundreds died—more than 200 of them in Karachi, **Pakistan's** largest city—and thousands lost their homes in flooding in the Indian subcontinent. Pakistan's coast was further battered by a cyclone.

An annual report produced by the United Nations on illegal drugs gave warning that opium production is soaring out of control in **Afghanistan**. It said that Helmand province alone produces almost half the world's illegal opium. See article

Fast track to nowhere

It seemed likely that **George Bush** would lose the negotiating powers that allow the president to fast-

track trade deals through Congress. A last attempt to persuade Congress to renew the provision, which expires on June 30th, was thwarted when talks over farm subsidies and open markets between America, the European Union, Brazil and India, the so-called “G4”, broke down last week.

A Senate committee issued **subpoenas** to the White House and Dick Cheney's office ordering them to turn over documents related to the domestic “eavesdropping” national-security programme.

The Supreme Court loosened restrictions on **political advertisements** in the weeks prior to an election, watering down a provision of the McCain-Feingold act.

Friends and enemies

Meeting for the first time since the Islamists of Hamas took over the Gaza Strip, **Israel's** prime minister, Ehud Olmert, told the **Palestinian** president, Mahmoud Abbas, that he would free 250 Palestinian prisoners loyal to Mr Abbas's Fatah movement. At the meeting in Sharm el-Sheikh, an Egyptian resort, he also told the Egyptian and Jordanian leaders that he would work with “moderates” such as Mr Abbas against “terrorists”, meaning Hamas. See article

A bomb killed six soldiers serving in a UN peacekeeping force in southern **Lebanon**. The culprit was not identified; Sunni Arab jihadists were widely suspected.

Ali Hassan al-Majid, or “Chemical Ali”, Saddam Hussein's cousin who oversaw the slaughter of as many as 180,000 **Iraqi Kurds** in the 1980s in what was known as the Anfal (Spoils) campaign, was sentenced to death by a court in Baghdad. Two colleagues were also sentenced to hang, two got life sentences and one was acquitted. See article

Several **Sunni tribal leaders** who had been co-operating with the Iraqi government against al-Qaeda-linked insurgents in the western province of Anbar were among a dozen people killed by a suicide-bomb in a Baghdad hotel.

Zimbabwe's government published a draft law to make virtually all publicly traded companies cede controlling interests to black citizens who were “disadvantaged by unfair discrimination on the grounds of his or her race” before April 1980, when the country won independence.

Chávez gets even tougher

Four oil companies, including Exxon Mobil and Conoco-Philips, refused to sign new contracts that grant **Venezuela's** government a majority stake in operations in the Orinoco heavy-oil belt; seven other multinational companies have agreed to the terms. See article

Mauricio Macri, a conservative, easily won a run-off election for mayor of **Buenos Aires**, defeating by 22 percentage points a candidate backed by Néstor Kirchner, Argentina's left-of-centre president.

Mexico purged 284 senior officers of the federal police forces, including some top commanders, as part of its effort to grapple with infiltration of the state by drug traffickers.

Some **Andean football** fans breathed again, as FIFA relaxed a ban on World Cup qualifying matches being played at high altitude. The new limit will be 3,000 metres (9,800 feet), rather than 2,500 metres. That rules in Bogotá (Colombia) and Quito (Ecuador) but still rules out Cusco (Peru) and La Paz (Bolivia).

AP

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Business this week

Jun 28th 2007
From The Economist print edition

Russia's energy politics was in the spotlight again. **Gazprom,** the gas monopoly, finalised an agreement with **Eni**, an Italian energy company, to build a pipeline under the Black Sea that will deliver gas to Italy and eastern Europe, increasing European reliance on Russian fuel. Earlier, **BP's** Russian joint venture, TNK-BP, responded to warnings from Russian regulators that its operating licence in the **Kovykta** Siberian gas project was under threat by selling its stake in the field to Gazprom.

Meanwhile, **PricewaterhouseCoopers** denied that it had succumbed to pressure from the Kremlin as it withdrew audits covering ten years for **Yukos**. The Russian oil company was declared bankrupt last year after it fell foul of the authorities and received a crippling claim for back taxes. See article

Iberdrola continued its spending spree in America by agreeing to pay $4.5 billion for New England-based **Energy East**. The Spanish utility has bought a number of wind-farm operations in the United States over the past year in line with its strategy to expand its renewable-energy business. However, its acquisition of Energy East, which provides gas and electricity, was interpreted by some analysts as a defensive move against potential takeovers.

In arms way

BAE Systems revealed that it is being investigated by America's Justice Department over its compliance with anti-corruption laws. The inquiry covers BAE's dealings with Saudi Arabia. Europe's largest defence company, a big supplier to the Pentagon, has found itself the centre of media attention over alleged payments to Saudi royalty. BAE maintains it has done nothing wrong. An investigation by Britain's Serious Fraud Office into a multi-billion arms deal with the Saudis in the 1980s, in which BAE was the main contractor, was halted by Tony Blair last December on the ground that it was damaging British-Saudi relations. One of Gordon Brown's first decisions as prime minister will be whether the British government should co-operate with the American inquiry.

The **London Stock Exchange** announced a merger with **Borsa Italiana**, valuing the Italian exchange at *euro*1.6 billion ($2.2 billion). The deal became all the sweeter for the LSE after reports that Borsa Italiana had rejected a tentative, and higher, offer from NYSE Euronext, the LSE's American-European rival.

Bear Stearns decided against rescuing one of the hedge funds that came close to collapse last week after suffering heavy losses in America's subprime mortgage market. The investment bank subsequently had to pledge only half the amount it had been prepared to offer the other hedge fund, $1.6 billion.

The price is right?

After surging by 13% on its stockmarket debut last week, **Blackstone Group's** share price dropped sharply, falling below the $31 set at the initial public offering. Amid concerns about legislation introduced in America to increase the tax rate for private-equity firms, investors were spooked by a report that the buy-out boom may have peaked. The trajectory of Blackstone's share price was no doubt tracked by rivals, such as Kohlberg Kravis Roberts and Carlyle Group, that are considering a public offer. See article

Following recent warnings about contaminated pet food and toothpaste, more concerns were raised about the quality of **Chinese products** when American safety regulators demanded a recall of 450,000 defective tyres.

Roche, a Swiss drugmaker with a large portfolio of cancer treatments, launched a $3 billion hostile bid for **Ventana Medical Systems**, which is based in Tucson and specialises in tests for cancer. See article

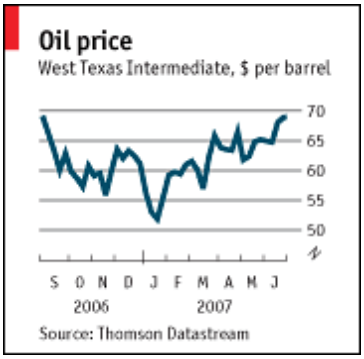
Blockbuster said it had settled a patent dispute brought by **Netflix,** which pioneered the successful business of renting DVDs online for delivery by mail in the late 1990s. The business model has been

widely copied elsewhere. Terms of the settlement were not divulged.

After months of waiting, the **iPhone** was finally due to go on sale in America. Apple has touted its latest product as the biggest thing since the iPod. However, some techies have faulted the iPhone's slow data speeds and short battery life (Apple now says the battery will last for around eight hours of talk time) and balked at the high price of the device's network calling rates.

Creeping up

Oil prices traded around ten-month highs, even as the threat of a shutdown to Nigeria's oil industry from labour unrest receded. Meanwhile, the head of OPEC insisted there was no need for the cartel to increase production to ease oil prices, which, he said, were rising partly because of geopolitical tensions.



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KAL's cartoon

Jun 28th 2007
From Economist.com

Kevin Kallaugher

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American power

Still No.1

Jun 28th 2007
From The Economist print edition

Kevin Kallaugher

Wounded, tetchy and less effective than it should be, America is still the power that counts

EVEN the greatest empires hurt when they lose wars. It is not surprising then that Iraq weighs so heavily on the American psyche. Most Americans want to get out as soon as possible, surge or no surge; many more wish they had never invaded the country in the first place. But for a growing number of Americans the superpower's inability to impose its will on Mesopotamia is symptomatic of a deeper malaise.

Nearly six years after September 11th, nervousness about the state of America's “hard power” is growing (see article). Iraq and Afghanistan (another far-off place where the United States, short of troops and allies, may be losing a war) have stretched the Pentagon's resources. An army designed to have 17 brigades on active deployment now has 25 in the field. Despite bringing in reservists and the National Guard, many American troops spend more than half their time on active duty; the British spend a fifth.

Other demons are jangling America's nerves. There is the emergence of China as a rival embryonic superpower, with an economy that may soon be bigger than America's (at least in terms of purchasing power); the re-emergence of a bellicose, gas-fired Russia; North Korea's defiance of Uncle Sam by going nuclear, and Iran's determination to follow suit; Europe's lack of enthusiasm for George Bush's war on terror; the Arabs' dismissal of his democratisation project; the Chávez-led resistance to Yankee capitalism in America's backyard.

Nor is it just a matter of geopolitics. American bankers are worried that other financial centres are gaining at Wall Street's expense. Nativists fret about America's inability to secure its own borders. As for soft power, Abu Ghraib, Guantánamo Bay, America's slowness to tackle climate change and its neglect of the Palestinians have all, rightly or wrongly, cost it dearly. Polls show that ever fewer foreigners trust America, and some even find China's totalitarians less dangerous.

Power to the wrong people

A sense of waning power is not just bad for the self-esteem of Americans. It is already having dangerous consequences. Inside the United States, “China-bashing” has become a defensive strategy for both the left and the right. Isolationism is also on the rise. Most Democrats already favour an America that “minds its own business”.

Outside America, the consequences could be even graver. Iran's Islamic revolutionaries and Russia's Vladimir Putin have both bet in different ways that a bruised Uncle Sam will not be able to constrain

them. Meanwhile, a vicious circle of no confidence threatens the Western alliance: if Italy, for instance, concludes that a weakened America will not last the course in Afghanistan, then it will commit even fewer troops to the already undermanned NATO force there—which in turn prompts more Americans to question the project.

Yet America is being underestimated. Friends and enemies have mistaken the short-term failure of the Bush administration for deeper weakness. Neither American hard nor soft power is fading. Rather, they are not being used as well as they could be. The opportunity is greater than the threat.

It is hard to deny that America looks weaker than it did in 2000. But is that really due to a tectonic shift or to the errors of a single administration? Dick Cheney and Donald Rumsfeld reversed the wise Rooseveltian doctrine, “Speak softly and carry a big stick”. After September 11th the White House talked up American power to an extraordinary degree. In that brief period of “shock and awe” when Americans were from Mars, their Venutian allies were lucky to get invited to the show (indeed, in Afghanistan some “old” Europeans were initially turned away). Meanwhile, Mr Bush declared a “war on terror”, rather than just on al-Qaeda, broadening the front to unmanageable dimensions (and paving the way for Guantánamo).

While the talk was loud, the stick was spindly. Defying his generals, Mr Rumsfeld sent too few troops to Iraq to pacify the country. Disbanding the Iraqi army compounded the error. Regardless of whether Iraq was ever winnable, it is hard to imagine any future American administrations making such schoolboy howlers when it comes to regime change.

America the indispensable

Yet in one way Mr Bush is unfairly maligned. Contrary to the Democratic version of history, America did not enjoy untrammelled influence abroad before he arrived. The country that won the cold war also endured several grievous reverses, notably Vietnam (where 58,000 Americans were killed—16 times the figure for Iraq). Iran has been defying America since Jimmy Carter's presidency, and North Korea for a generation before that. As for soft power, France has been complaining about Coca-Cola and Hollywood for nearly a century.

From this perspective of relative rather than absolute supremacy, a superpower's strength lies as much in what it can prevent from happening as in what it can achieve. Even today, America's “negative power” is considerable. Very little of any note can happen without at least its acquiescence. Iran and North Korea can defy the Great Satan, but only America can offer the recognition the proliferating regimes crave. In all sorts of areas—be it the fight against global warming or the quest for an Arab-Israeli peace—America is quite simply indispensable.

That is because America still has the most hard power. Its volunteer army is indeed stretched: it could not fight another small war of choice. But it can still muster 1.5m people under arms and a defence budget almost as big as the whole of the rest of the world's. And it could call on so much more: in relation to the country's size, its defence budget and army are quite small by historical standards. Better diplomacy would enhance its power. One irony of the “war on terror” is that Mr Bush's hyperventilation worked against him in terms of getting boots on the ground: neither his own countrymen nor his allies were sure enough that they were really under threat. (And why should they be? An American-led West spent four decades tussling with a nuclear-armed empire that stretched from Berlin to Vladivostok; al-Qaeda is still small beer.)

The surveys that show America's soft power to be less respected than it used to be also show the continuing universal appeal of its values—especially freedom and openness. Even the immigrants and foreign goods that so worry some Americans are tributes to that appeal (by contrast, the last empire to build a wall on its border, the Soviet one, was trying to keep its subjects in). Nor is it an accident that anti-Americanism has fed off those instances, such as Guantánamo Bay, where America has seemed most un-American. This is the multiplier effect that Mr Bush missed: win the battle for hearts and minds and you do not need as much hard power to get your way.

That lesson is worth bearing in mind when it comes to the challenge of China. China is likely to be more and more in America's face, whether buying American firms, winning Olympic gold or blasting missiles into space. Merely by growing, China is disrupting the politics of the Pacific. But that does not mean that it is automatically on track to overtake America. Its politics are fragile (see article) and America's lead is immense. Moreover, economics is not a zero-sum game: so far, a bigger China has helped to enrich

America. An America that stays open to China—an America that sticks to American values—is much more likely to help fashion the China it wants.

If America were a stock, it would be a “buy”: an undervalued market leader, in need of new management. But that points to its last great strength. More than any rival, America corrects itself. Under pressure from voters, Mr Bush has already rediscovered some of the charms of multilateralism; he is talking about climate change; a Middle East peace initiative is possible. Next year's presidential election offers a chance for renewal. Such corrections are not automatic: something (a misadventure in Iran?) may yet compound the misery of Iraq in the same way Watergate followed Vietnam. But America recovered from the 1970s. It will bounce back stronger again.

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Hong Kong

One country, no democracy

Jun 28th 2007
From The Economist print edition

If only Hong Kong were allowed to show China the way politically as it has economically

EPA

Get article background

WHEN China took back sovereignty over Hong Kong ten years ago, it promised to preserve its unique "way of life". The imaginative formula for doing this had two parts. The first was "one country, two systems"—ie, Hong Kong would still be capitalist, while China would pretend, ever less convincingly, to be socialist. The other was "Hong Kong people ruling Hong Kong". As China's leaders descend on Hong Kong this weekend for tenth-anniversary fireworks and self-congratulation, the place is booming and has changed far less in ten years than has almost any other city in China (see our special report). Its capitalist system is largely intact. But on its commitment to let Hong Kong people run Hong Kong, China has flouted its promise of autonomy in everything apart from foreign affairs and defence. This is a potential disaster for Hong Kong, and a missed opportunity for China.

China has ensured that elections to Hong Kong's legislature, and those for the "chief executive"—the successor to Britain's colonial governors—are elaborately rigged in favour of "pro-China" candidates. Pointing to Hong Kong's success as an undemocratic British colony, and its continued success as a slightly less undemocratic "special administrative region" of China, the Communist Party can argue that this shows it was right to deny Hong Kong full democracy. That is nonsense.

It is true that, to its shame, Britain never bestowed democracy on Hong Kong. But it did endow it with strong institutions such as an independent judiciary and a free press. They are crucial to Hong Kong's standing as a truly global city. They have survived the past ten years better than many feared. But both have suffered some erosion. Worse is to come unless Hong Kong has a government with the legitimacy to defend them. And that requires a proper democratic mandate.

Curiously, many of those businessmen in Hong Kong who used to argue that full democracy would serve only to destabilise the place and make China cross have become converts to democracy, despite the flourishing economy. They realise that the present constitutional muddle simply does not work: the lack of democratic legitimacy leads to a constant search for an elusive consensus and indecisive government.

The Hong Kong model

There is another reason why democracy in Hong Kong should be welcomed by the government in Beijing: Hong Kong could serve as a laboratory for political change on the mainland, as it earlier served as an economic model.

A crucial element of the reforms unleashed in China by Deng Xiaoping nearly 30 years ago was the recognition that Hong Kong had much to offer China. He saw how much its entrepreneurial people and their capital could do for the mainland; and he copied some of its economic freedoms. Often judged the world's freest economy, Hong Kong is not a bad model. The Pearl River Delta—Hong Kong's hinterland—became China's fastest-growing region.

Hong Kong could now play a similar role in politics, where the Communist Party is again toying with the idea of reform (see article). China remains a viciously repressive dictatorship, where any weakness of the central government is compensated by the even more arbitrary exercise of power by local authorities. But people are immeasurably freer now than they were 30 years ago.

Every year sees tens of thousands of protests—many by peasants over official land grabs. But the new property-owning, shareholding middle classes are also restive. None of this, so far, amounts to a challenge to Communist Party rule. But it does suggest that the instability the party fears may come. Hong Kong would be a good place to try an alternative way of dealing with dissent. On Sunday, after the fireworks have fizzled and China's and Hong Kong's leaders have told each other how well they are doing, tens of thousands of Hong Kongers will take to the streets to demand their democratic rights. It is fair to predict that they will do so without violence and with considerable good humour. They should be cheered on by everybody who wishes China well.

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British politics

The coronation

Jun 28th 2007
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Gordon Brown has the makings of a disappointing prime minister—and also of a fine one

REX/Bridgeman

Gordon Brown

HE HAS waited so long, his ambition has been so palpable, and his thrill at realising it is so obvious, that perhaps only a churl could begrudge Gordon Brown his moment of triumph on June 27th. And there were indeed plenty of churls eager to rain on his short parade back to Downing Street from Buckingham Palace, where, after Tony Blair resigned, the queen invited Mr Brown to form her government.

He has grasped the main prize of British politics in a strange way—without a vote in either his party or the country—and at a puzzling time. Even despite Iraq, Mr Blair has gone less because he has failed than because he and the public have had enough of each other. Mr Brown inherits what is, in electoral terms, the most successful Labour administration in history, but with the distinction between the parties blurred, and faith in politicians of all sorts fast evaporating. The country he now leads is at once buoyant and disgruntled.

All that, plus the grumpy personality he has displayed as chancellor of the exchequer and dauphin, suggest to some that he is fated to lead his party to defeat and his country backwards. He may be a flop. Yet the same circumstances could make him surprisingly successful.

A damp squib

For all the rashness of Iraq, only late did Mr Blair shake off the bad habits picked up during Labour's long years in opposition: a tendency to cravenness, and to over-hype petty achievements. Part of the glum view of Mr Brown is that his decade spent coveting his Downing Street neighbour's job has reinforced those habits. Even more desperate to keep it than most incoming prime ministers, Mr Brown may waste his longed-for premiership in petty fiddling and cynical populism.

Worse—say the doomsayers—the Conservative opposition will win the bet it has in effect placed on him. The Tory gamble is that, left to his own devices, Mr Brown will stall or even undo Mr Blair's limited, belated but real reforms to Britain's public services, placing less faith in the power of choice and competition to improve schools and hospitals, and reviving the emphasis on targets that failed in Labour's first term.

In this view Mr Brown is destined to creep timidly towards a general election, probably delaying it as long

as possible. Meanwhile, interest rates may continue to rise, squeezing voters in marginal and crucial southern constituencies. Lightning may strike along the way, in the shape of a military confrontation with Iran, or more terrorist attacks in Britain. Even if he narrowly won his election, or cobbled together a coalition with the Liberal Democrats, he would struggle to control Parliament—especially if the grudge-bearing and control-freakery that have already alienated colleagues make him still more enemies. Thus he will become what he most fears: a gloomy coda to Mr Blair, a leader who reprises some of his predecessor's mistakes, adds some new ones, and lacks the charm.

Yet mixed up with the temper and neuroses, Mr Brown has qualities that Mr Blair lacks—ones that might serve him well in Number 10. He has an intellect that is routinely described as formidable, and deep if not broad experience of government. He conveys a moral seriousness about domestic policy that Mr Blair often only impersonated. He vows more substance and less ingratiating spin, at which he is anyway less gifted. He arouses devotion as well as fear among underlings. He is, like him or not, no lightweight. And, liberated from his corrosive rivalry with Mr Blair, he may no longer be the thing he was, finding the elan and confidence to give power away instead of hoarding it, as he once did when ceding control over interest rates to an independent Bank of England in 1997.

Or a weather-maker?

The obvious way to signal change would be to hold a snap election. As leader of the majority party in Parliament, Mr Brown is not obliged to go to the country for his own mandate. Yet as government in Britain has become ever more presidential, that reasoning now looks to many like an arcane technicality. It is probably naive to expect Mr Brown to risk everything before he must, or before he feels sure he can win. But another way to reverse perceptions, and coincidentally to make Britain a better place, would be to address the presidential drift itself by devolving power to Parliament, local councils and—scotching the Tory bet—the public services.

Were it not for the half-hearted and ham-fisted way in which they were implemented, the constitutional reforms that Mr Blair pursued early in his premiership—devolution to Scotland and Wales; partial reform of the House of Lords; freedom of information—might have been regarded as his most important domestic legacy. If Mr Brown really means what he has recently been saying about humbler and more democratic government, he will finish the job of Lords reform, and address the most important defect of the British system—the over-mightiness of the executive and weakness of the legislature—by handing real authority to Parliament.

Foreign crises may test the nimbleness of Mr Brown's decision-making. The conflicts in Iraq and Afghanistan may divert his attention and sap his energy. But if he can keep enough of both for the causes about which he genuinely cares—such as third-world poverty, disease and climate change—he may succeed in being remembered as more than the fag-end of a stale regime. Since a government's achievements and duration are not always commensurate, he could forge a lasting legacy in only a few years. And if the Tories remain as flaccid as they sometimes appear, he could win the extra term in office that he craves on the strength of his own record.

The closest analogy to Mr Brown's situation in post-war history is with Anthony Eden, who spent much of his life waiting for Winston Churchill to retire. “I don't believe Anthony can do it,” was Churchill's last-minute verdict on his successor. He was right. Mr Blair has sometimes seemed to feel similarly about Mr Brown, and that may be right too. But Mr Brown may yet amaze the churls, emerging from the chrysalis of the Treasury a bold and principled leader, and justifying the hopes stoked by Labour's dizzy victory ten years ago.

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The European Union summit

Trick or treaty?

Jun 28th 2007
From The Economist print edition

A bitter summit, a stripped-down treaty: a pity the voters are unlikely to be given a say

Peter Schrank

PERHAPS it was the weather, perhaps the grimness of their fortress building. At all events most European Union leaders seemed grumpy about the new treaty that they cobbled together in Brussels in the small hours of June 23rd. Maximalists who wanted to preserve the entire constitution rejected by French and Dutch voters in mid-2005 were aghast at concessions to minimalists such as Britain and Poland. Yet minimalists also fretted about accepting too much. No wonder the atmosphere was bitter (see article).

At least a deal was done, thanks partly to the determined chairmanship of Germany's Angela Merkel, partly to the pizzazz of France's hyperactive new president, Nicolas Sarkozy. If a full treaty is now drawn up in an inter-governmental conference, and if it is ratified by all 27 members—which remain big ifs—the EU can at last put behind it a rancorous decade of squabbling over its institutions. And a club that has spent far too much time looking inwards can turn to more important outward concerns: energy security, climate change, relations with Russia, its place in the world.

Although the new text is now labelled a “reform treaty”, it reprises most of the institutional changes put forward in the constitutional treaty in 2004. Many of these (eg, “double majority” voting, a smaller European Commission, a single foreign-policy post instead of two, more say for national parliaments) will be clear improvements that also steer clear of further centralisation. But others, such as giving the 2000 charter of fundamental rights full legal status and more majority voting in justice and home affairs, are undesirable both on their merits and because they transfer power to Brussels. Perhaps the worst change made by the summit was to accept a last-minute bid by Mr Sarkozy to drop a planned reference to free and undistorted competition as one of the union's key objectives. Although the language was later reinstated in a protocol, Mr Sarkozy was still crowing as he left Brussels, asking “what has competition ever done for us?” (see article).

The EU is likely to function a little better with the new treaty than without it. But should it be put to referendum? This treaty is shorter than the one French and Dutch voters rejected in 2005 and it ditches the pompous state-like trappings, such as an anthem and a flag, proposed in the original. But most of the substantive changes the French and Dutch electorates rejected are still in it. EU leaders are now so terrified of further No votes that only Ireland's is ready to risk one. But in all ten governments promised referendums on the constitutional treaty. As *The Economist* argued before the summit, to go back on these promises now requires those governments to show that the new treaty is truly minimalist and involves no substantial transfer of power to Brussels. They can't, because it does.

Paradoxically, only the British can even begin to argue such a case, because only Britain has secured opt-outs from the two biggest transfers of power (the charter of fundamental rights and majority voting in

justice and home affairs). For other countries that had promised a vote, the case in principle for a referendum on the new treaty is still strong, even if only the Irish admit it and if public clamour elsewhere has faded. If, as seems likely, the new treaty is ratified without popular votes, the politicians will be able to congratulate themselves on having smuggled through the back door what they failed to bring in through the front. It is a sorry end to a decade-long effort to warm up Europeans' tepid enthusiasm for the EU.

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Pharmaceuticals

From bench to bedside

Jun 28th 2007
From The Economist print edition

A reform of American regulation would mean better drugs for everybody

Getty Images

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THE notorious red tape at a government agency like America's Food and Drug Administration (FDA) is, in the words of Milton Friedman, “a consequence of its constitution in precisely the same way that a meow is related to the constitution of a cat.” Friedman often argued that the agency's heavy-handed, over-cautious approach to drug approval did more harm than good by stifling innovation and delaying the arrival of life-saving new medicines on the market.

Few are likely to agree with his conclusion that the FDA is unreformable and must be abolished outright—therein lies a tort lawyer's paradise. But signs that the industry is beginning to shift away from a few blockbuster drugs towards a larger number of products targeted at less common diseases or particular patient groups (see article) strengthens the argument for lightening the regulatory burden and shifting the balance away from guarding public safety and towards encouraging innovation.

Faster and better

The number of new drugs securing regulators' approval is dropping as the cost and length of clinical trials grow. The launches of a string of blockbuster drugs—including Avandia, a diabetes drug made by GlaxoSmithKline, and Zimulti, an obesity drug by Sanofi-Aventis—have recently gone awry. Studies have suggested that the costs of the FDA's regulations may outweigh the benefits (see article). All this explains why America's Congress is now considering an FDA reform bill. Because the FDA is the world's principal drugs regulator, everyone has a stake in what happens.

The starting point is that the FDA and its counterparts across the world need to move from a risk-obsessed, “one size fits all” approach to a more flexible system that considers the risks and benefits of new therapies. Rather than asking drugs to undergo many years of costly trials in the vain pursuit of medicines that are safe for all in all circumstances, regulators should allow speedier conditional approvals. This is especially true for the growing number of targeted therapies, such as several excellent new cancer treatments, made possible by advances in genomics—a science that identifies which genetic groups will benefit from a drug.

If initial tests and sophisticated computer modelling show promise, innovative new drugs should proceed to small human trials. Ultimately, the drug could be approved for use by a wider part of the general

population deemed (through genetic testing and other screening methods) to be at relatively low risk or more likely to benefit from the therapy.

Safeguards can counterbalance this relaxation. Faster approval of new drugs in humans should be matched by more rigorous post-launch testing and surveillance. At the moment, the FDA does not have the money or authority to do this properly. Scores of post-launch studies of drugs safety have been requested by regulators, but remain undone or ignored by firms. And yet there is reason to think such post-launch surveillance, if bolstered by the use of electronic records and “data mining” techniques, could save many lives. When Vioxx, a blockbuster pain remedy made by Merck, turned out to be dangerous for some patients, private health-management organisations with excellent electronic patient records spotted the problem months before the FDA did. The second safeguard is for all drugs trials done anywhere in the world—failed or successful—to be made public and the data published online. Consumers would have the information they need to choose whether to take a drug, weighing benefit against risk. Companies would benefit from a cheaper and faster approvals process, and a lower risk of litigation.

By cutting the costs of approval, lighter regulation should help move the industry away from blockbusters towards niche products. A reformed FDA might thus speed the arrival of the long-promised age of personalised medicine. Even if it survived, Friedman would surely approve.

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Global trade talks

Potsdam's price

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Brazil's and India's backtracking on the Doha round is a mistake

Claudio Munoz

Get article background

BLAME for the sorry state of the Doha trade talks belongs in many quarters. The European Union has been unwilling to open its protected food markets and America has been slow to offer real cuts to its most trade-distorting farm subsidies. But the latest Doha setback—a failed ministerial summit between the round's self-styled leaders, America, the EU, India and Brazil, in Potsdam on June 21st—had less to do with rich-world rigidity than Indian indifference and Brazilian brinkmanship.

Last summer India's trade minister, Kamal Nath, arrived hours late for a critical negotiation in Geneva, too busy watching the World Cup to save the global trade talks. At Potsdam, he was tardy again and quick to tell journalists that he intended to leave early. More surprising were the tactics of Celso Amorim, Brazil's trade minister. He was disappointed by the offer the Americans made on agriculture. In return, he offered cuts in industrial tariffs that were, if anything, even more vacuous. A meeting meant to narrow differences has widened them.

The emerging economies' desire to squeeze more subsidy cuts out of the Americans is understandable. Washington's trade negotiators claim that it is oh-so-painful to reduce America's ceiling for trade-distorting subsidies to $17 billion a year (from today's limit of $22 billion), and quite impossible to go any lower. Their whining rings hollow when booming commodity prices meant America actually spent only $11 billion on subsidies last year. George Bush's trade negotiators should put a more generous offer on the table.

Just as America is allowed more protection for its farmers than it actually offers, so with emerging countries and their industrialists (see article). And in the same way that America needs to cut the subsidies actually handed out as well as those on paper, so emerging economies must accept cuts not just in their maximum tariff levels, but also in their effective levels.

Beyond the brinkmanship

Brazil and others ought to embrace bold tariff cuts as a route to a more vibrant economy. Only in the mercantilist mindset of trade negotiations, after all, is tariff-cutting a “concession”. But even in the tortured logic of trade talks, the decision to abandon the Potsdam negotiations was ill-conceived. That is because the death of Doha—now the round's most likely outcome—could be especially costly for big

emerging economies.

In the absence of a Doha deal, rich countries would find ways of raising barriers against these fast-growing emerging upstarts. America's Democrat-controlled Congress bubbles with scepticism about globalisation. Much of its impatience is focused on China. But it is also wary of the “offshoring” of services to India and shows no lack of enterprise in its search for fresh demons. Congress is also due to write a new farm bill. With no Doha deal to impose discipline, the volume of trade-distorting subsidies could surge.

Without Doha, the big emerging economies will have to file formal complaints at the WTO's dispute-settlement tribunal to force rich countries to lower their farm subsidies. Thus, Doha's demise would almost certainly spell a surge in WTO litigation, putting the multilateral system under enormous strain. If many judgments go against America, Congress would surely question the WTO's legitimacy.

All told, the death of Doha would be far worse than a missed opportunity. That is something the world's big emerging economies ought not to forget.

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On the environment, Paris Hilton, Sri Lanka, DP World, animal sacrifices, Apple, the future

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Environmental concerns

SIR – It is right to argue that a carbon tax is preferable to a cap-and-trade system, but you understate the case to be made for such a tax ("Cleaning up", June 2nd). The cap-and-trade system is not working because it is expensive and difficult to administer and is applied only to those polluters that can be identified. A carbon tax, on the other hand, could be levied on all fossil carbon at the point of extraction or import. It would force every user of energy to consider the economic implications of carbon emissions and remove the need to subsidise alternatives. Tax levels would be adjusted in relation to consumption and the consequent achievement of carbon targets. Logically, it would replace taxes on road fuel.

Bill Young
Arlesheim, Switzerland

SIR – You should have discussed the downside of a carbon tax. It may set a static price, but there is no guarantee that a carbon tax will adequately reduce carbon emissions. Energy markets are inelastic and inefficient; even relatively high taxes on fossil fuels have had only small effects on energy use. This is especially true for gasoline markets, where high price increases have a limited effect in reducing demand. As you noted, price fluctuations occur in the European cap-and-trade system because the initial allocation of credits was too generous, rather than any inherent price volatility in carbon markets. A properly administered cap-and-trade network would result in less price volatility and provide proper market signals to its participants.

John Clancy
Milwaukee

SIR – There is no need to credit Fidel Castro with being in "the vanguard" of efficient lighting or to call for a ban on incandescent light bulbs (Special report on business and climate change, June 2nd). As incandescent bulbs cost more to run, educate the public and let the market work. This happened in Japan, where low-energy fluorescent light now accounts for more than 95% of residential lighting. Contrast that with America and Europe, where inefficient incandescent bulbs still make up, respectively, 65% and 45% of the residential market.

Vaclav Smil
University of Manitoba
Winnipeg, Canada

SIR – Incandescent bulbs cannot be compared to low-energy fluorescent ones. Fluorescent bulbs emit a pallid, bleached light that is okay for hallways and porches, but which fails to flatter and provide a good quality of light for living rooms. To outlaw traditional light bulbs would curtail the public's access to perhaps the cheapest and most effective means of making their homes more attractive, namely the thoughtful use of interior lighting.

Jody Ketteringham
Farnborough, Hampshire

Hilton checks out

SIR – There is some validity to Tony Blair's reproach to journalists for, as you put it, "the elevation of

sensation and controversy above straight reporting" ("Poking sticks at lions", June 16th). During the Paris Hilton saga I was disturbed to see the BBC (yes, the BBC) present as "breaking news" the story that the celebrity heiress would have to serve her time in jail after all.

Karlis Streips
Riga, Latvia

Conflict in Sri Lanka

SIR – Contrary to your assertion, it is the Liberation Tigers of Tamil Eelam (LTTE), and not the government of Sri Lanka, whose intransigence is proving to be a setback for peace ("A war strange as fiction", June 9th). The government remains committed to a negotiated political settlement to address the grievances of all communities: proposals to devolve more power to the provinces are to be released shortly and there are well established mechanisms in place to investigate alleged acts of violence involving the government. Unlike the LTTE, the government does not engage, as you said, in "strategies of terror". It has taken military action only to protect its citizens from armed aggression under the LTTE's brutal tyranny.

You presuppose that the LTTE represents the Tamil community, which is not the case. Any attempt to explain ruthless terrorism as a consequence of government policy only legitimises terror.

Kshenuka Senewiratne
High commissioner for Sri Lanka
London

Politics and commerce

SIR – You accepted as fact the perception that last year's uproar over DP World buying some port operations in the United States was all about national security ("DP World's long shadow", June 16th). As any astute observer of inside Washington's Beltway would know, the uproar was more to do with the political dynamics of an election year. As proof, consider the Secure Freight Initiative, the American programme launched in direct response to our crisis: DP World is the central partner in the private sector. In other words, we are building a programme to protect America from the very same threat that Congress said we posed to America in the first place. No one on Capitol Hill has uttered a word of protest.

Michael Moore
Senior vice-president
DP World
Dubai

Business offering

SIR – It was interesting to note that an airline in Turkey considered sacking some exuberant employees who sacrificed a camel to mark the modernisation of its fleet of aircraft ("Flying the flag", June 16th). Many years ago I was involved in a project to commission a high-pressure water pipeline in Jamaica and took the advice of the local shaman to sacrifice a goat before turning on the pumps. It worked and no one got the sack. To this day, I do not know how much I owe the goat.

Barry Walton
Milford, Surrey

A bite at Apple

SIR – I disagree with your paean to Steve Jobs ("The third act", June 9th). Fed up with PCs, Microsoft and viruses, I switched to Apple a couple of years ago. My experience to date: an Apple PowerBook screen that is on the blink, a defective Mac desktop screen, a faulty iBook laptop motherboard, and three dead iPods. I admire their software, but Apple's hardware is appalling. The only protection is buying expensive insurance known as AppleCare. Innovation, yes. Quality, no. Customer care, forget it.

Raj Merchant
Morristown, New Jersey

Future imperfect

SIR – Your leader on RNA took Samuel Goldwyn's advice to “never make predictions—especially about the future” (“Biology's Big Bang”, June 16th). And an earlier book review cited the great Yogi Berra as uttering, “It's tough to make predictions, especially about the future” (“The perils of prediction”, June 2nd). Actually, the quote is usually attributed to Niels Bohr as the original source. In response to a question asking him to analyse the prospects for quantum physics, the Danish scientist said, somewhat tongue in cheek, that it is very difficult to make predictions, particularly about the future.

Bertil Petersson
New York

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American power

The hobbled hegemon

Jun 28th 2007 | CAMP LEJEUNE AND FORT BRAGG
From The Economist print edition

Its troubles in Iraq have much weakened it; but America is likely to remain the dominant superpower

Alex Williamson

THE men and women of America's 82nd Airborne Division, whose battle honours include the D-Day landings of the second world war, like to call themselves the nation's "911" emergency service—ready to parachute in, at a moment's notice, to any troublespot in the world. When Saddam Hussein invaded Kuwait in 1990, the 82nd Airborne was the first to deploy in Saudi Arabia to hold the line. And when George Bush announced his surge of forces into Baghdad last January, the "All-Americans" were the first reinforcements.

These days, though, the 82nd Airborne is no longer America's quick-response service. Its sprawling base at Fort Bragg, North Carolina has emptied out, with all four of its brigades now fighting in Iraq and Afghanistan. For the rest of the year at least, the high-readiness brigade is provided by the 101st Airborne Division. Still, the All-Americans insist they can be counted on to "fight and win" in other places if needed. One divisional command sergeant-major says the paratroopers can deploy from anywhere to anywhere and always take their parachutes, just in case.

A two-hour drive from Fort Bragg, at Camp Lejeune, home of the II Marine Expeditionary Force, officers say they too are operating "with engines at full throttle". They no longer have time to rehearse major assault operations, and their training for counter-insurgency is hampered by equipment shortages. Indeed, about half the marines' pre-positioned kit, stored on ships around the world and in vast Norwegian caves, has been drawn down to give front-line fighters what they need.

Such signs of strain on America's military forces are like dead "canaries in the mineshaft" that warn of impending disaster, says Andrew Krepinevich, president of the Centre for Strategic and Budgetary Assessments, a defence think-tank. In the sixth year of the "war on terror" deployments in war zones are ever longer, while "dwell time" at home to recover is shorter. The army and marines say morale remains strong but, equally, they say the current tempo cannot go on indefinitely. At some point either the resources must increase, or demands on the forces must be reduced.

Even before the surge was announced, Colin Powell, the former secretary of state and an ex-chairman of the joint chiefs of staff, said that the active army was "about broken". The outgoing military chief, General Peter Pace, warned Congress earlier this year that America's ability to deal with another crisis in the world was being eroded. In a classified report, he said there was a "significant" risk that America would not be ready to respond properly to a series of possible military conflicts—from Korea to Taiwan, Cuba or Iran. America could still beat any likely enemy, said the general, but its response would be slower and bloodier.

America is the richest country and the most sophisticated high-tech military power in the world, and is spending more on defence in real terms than at any time since the end of the second world war. Yet it is being exhausted by insurgents armed with AK-47 assault rifles, rocket-propelled grenades and improvised bombs. With strong pressure on President George Bush to withdraw from Iraq, jihadist militants scent a victory as momentous as the eviction of Soviet forces from Afghanistan in 1989—a defeat that helped to dissolve the Soviet empire.

True, America has recovered from previous disasters, not least the Vietnam war. But its military troubles come at a time when the global strategic balance appears to be tilting away from America. Iran is filling the vacuum created in Iraq, and is accelerating its nuclear programme. China's military punch is growing along with its booming economy. Russia is more belligerent. The transatlantic relationship is loveless. Across the world, anti-Americanism has increased to the point where the United States is often regarded as a threat to world peace rather than its guarantor.

Strategists wonder whether the Iraq war has damaged America so badly as to set it on a path to "imperial decline". Is the post-Soviet "unipolar" world, established after America's first war against Saddam Hussein in 1991, coming prematurely to an end as a result of the second war to topple him? For Richard Haass, president of the Council on Foreign Relations, a leading think-tank, "the American era in the Middle East is over"—and because of the importance of the Middle East, American global power has also been weakened, for years if not for decades.

Zbigniew Brzezinski, national security adviser to Jimmy Carter, blames all three post-cold-war presidents for wasting America's moment of supremacy. In his recent book, "Second Chance", he praises George Bush senior for his handling of the collapse of Soviet communism with "delicacy and skill" but gives him only a B grade for failing to exploit the victory in Kuwait in 1991 to resolve the Arab-Israeli conflict. He gives Bill Clinton a mediocre C for his vacillation. George Bush junior gets an unforgiving F for his "catastrophic leadership". The most powerful image of America, says Mr Brzezinski, is no longer the Statue of Liberty but the prison camp at Guantánamo Bay. Unless Mr Bush's successor takes urgent steps to restore America's political and moral standing, he says, "the crisis of American superpower will become terminal", and the epoch of American dominance will be shortened.

It was a different George Bush who came to office in 2001, declaring that America had to use its unequalled power judiciously. "If we're an arrogant nation, they'll resent us," he said during his campaign. "If we're a humble nation, but strong, they'll welcome us." He accused Mr Clinton of squandering America's power by getting bogged down in the Balkans. Its military forces should be used for war-fighting, not nation-building. His then foreign-policy adviser, Condoleezza Rice, declared: "We don't need to have the 82nd Airborne escorting kids to kindergarten."

Slimmer, not better

Under the "transformation" envisaged by Mr Bush's defence secretary, Donald Rumsfeld, the army would be slimmed down and money invested in high-tech weapons, reconnaissance systems and data links. Speed, stealth and accuracy would substitute for mass. After the attacks of September 11th 2001, a new political doctrine also crystallised: leadership would substitute for consensus. America would free itself of the encumbrance of formal alliances and multilateral diplomacy. Mr Rumsfeld lived by the dictum that "the mission determines the coalition", not the other way around.

The swift removal of the Taliban in 2001 by a "coalition of the willing", relying on special forces backed by air power, seemed to validate such concepts. But in Iraq the light, mobile force that smashed its way to the centre of Baghdad was plainly inadequate for the task of garrisoning the country, securing the borders and arms dumps, confronting the insurgency and preventing the slide to sectarian war. America's decision to go to war without formal United Nations support left it with few friends when things went wrong.

Many will argue over the parallels between the failures in Iraq and Vietnam, but there is at least one connection. For decades after the fall of Saigon, traumatised American commanders gave up the study of messy "small wars" to concentrate on fighting the decisive "big war" against the massed armies of the Soviet block. Commanders assumed, wrongly, that forces trained to fight high-intensity battles could also handle low-intensity conflicts.

One cavalry officer, Lieut-Colonel Paul Yingling, has denounced the failure of America's generals—in Iraq as in Vietnam—to prepare the army for counter-insurgency. Calling, in the *Armed Forces Journal*, for

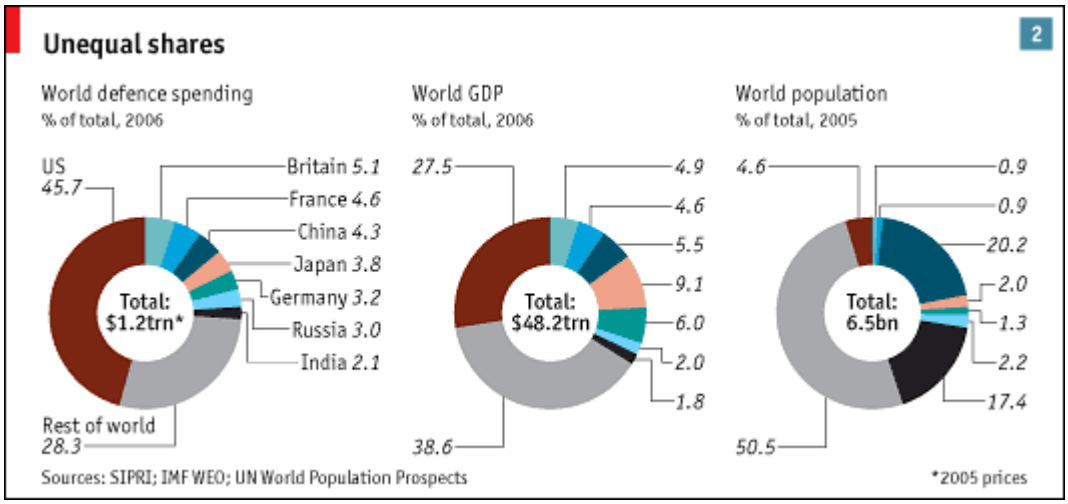
Congress to hold the top brass to account, he wrote: “As matters stand now, a private who loses a rifle suffers far greater consequences than a general who loses the war.” In fact, some changes have been made to adapt to the new face of warfare. Army and marine training centres have been reconfigured. Brigades now exercise in mock Iraqi villages, with thousands of actors playing civilians, Iraqi forces and insurgents. Gone are old-style clashes of massed steel on steel, and some commanders now worry that they are losing the skills to fight big conventional wars.

The recent joint army and marines counter-insurgency manual says the central aim is not to destroy the enemy but to protect civilians. Fighting insurgents involves “armed social work”, with key decisions often taken not by the general at headquarters, but by the corporal on the street. In other words, the main task for the 82nd Airborne Division and other army units for the foreseeable future, *pace* Ms Rice, will be nation-building in Iraq and Afghanistan. Above all, says the manual, counter-insurgency requires large quantities of two resources that America is short of: boots on the ground and time.

The Pentagon says America has the best-led, best-trained and best-equipped army ever fielded. “We are not a broken army, but we are working very hard,” insists one senior officer. “If you ask a marathon runner how he feels after 19 miles, he will say he is tired. That does not mean he is not in shape.” The trouble, though, is that America's forces were designed for sprints, not marathons.

America has some 1.5m men and women under arms, including nearly 700,000 in the army and marine corps. But only a fraction can be deployed on a prolonged basis because some units are unsuitable for counter-insurgency, while deployed troops need to be rotated periodically to give them time to recover.

Infographics



The army reckons it needs at least two brigades at home to sustain one in a war zone. That means the current total of about 50 army combat brigades and marine equivalents in the full-time forces should support about 17 in the field. But with the surge of five extra brigades to Iraq, America currently has 25 such brigades deployed around the world. The pressure is alleviated with part-time units from the National Guard and reserves (currently about two combat brigades), but their use is increasingly unpopular at home.

These days American units get nothing like the recommended 2:1 ratio of dwell time to deployment. Some army brigades currently get barely a year to rest and re-train after serving 15 months, a ratio of 0.8:1. By this measure, American ground forces get a fifth as much rest as their British counterparts—and British commanders say that anything less than two years at home for each six-month deployment (a 4:1 ratio) could “break the army”.

With some units now on their fourth deployment, an army medical survey in Iraq last month found higher levels of mental-health problems, including a 24% level of post-traumatic stress disorder among those on multiple combat tours. Less than half agreed that “all non-combatants should be treated with respect” and more than a third reckoned torture should sometimes be allowed.

Size matters

All this does not take into account America's need to keep forces ready to deal with unexpected

developments elsewhere. A study by the Congressional Budget Office (CBO)in April calculated that if the surge in Iraq lasts until April next year (the option floated by commanders in Iraq), only between three and 11 brigades would be available to deal with another crisis in the coming 18 months, depending on how much time units need to recover. But American plans for a major war to, say, defend South Korea have in the past envisaged dispatching 20 or 21 brigades, notes the CBO. With time, America could build up its forces for another campaign by sending or training lower-readiness units, mobilising reservists or, in extreme emergency, by reinstating the draft.

Clearly America needs a bigger army. The new defence secretary, Robert Gates, has belatedly announced plans to expand ground forces by an extra 62,000 troops—nearly a tenth of the total—to bring the army up to 547,000 and the marines to 202,000 by 2012. This will not immediately ease the strain, as it will take years to prepare new units. And even this rise may not be enough. According to the CBO, the increase would still not sustain the current surge in Iraq without breaching the rotation guidelines.

Some want an even bigger expansion, perhaps as many as 200,000 more troops. But can America find more soldiers? The army is already short of captains and majors, who take years to train. And despite more generous bonuses, the quality of new recruits is starting to drop, with more in the lowest aptitude ranking, more high-school dropouts and more receiving waivers from disqualification (for example, for using drugs or having a criminal record). The age limit for recruitment has risen from 35 to 42, while fitness levels are lower. Some complain that training standards have also suffered, as the army adopts gentler means to get more recruits through boot camp.

But even though recruitment is difficult, particularly at a time of high employment, the army is growing steadily, from 482,000 in 2001 to about 507,000 today. The army says it sees no need for some of the more radical proposals, such as a return of the draft or recruiting foreigners with the promise of American citizenship. In the 1980s the army alone had 780,000 soldiers, all of them volunteers. The army says the profile of its recruits remains above the average for the American population. The number of soldiers re-enlisting—often during service in war zones—remains high. Indeed, the striking thing about the army and marines is not their morale problems, but their resilience.

Even if the troops can be found, equipping them remains a problem. The army says it entered the war on terror with $56 billion-worth of equipment shortages, and kit is being worn out or destroyed much faster than expected. Everything from night-vision goggles to new body armour and armoured Humvees has to be shuffled around so that deployed units are fully kitted out, leaving those at home with even bigger gaps. The shortages are especially acute in the National Guard, which has only about half the equipment it needs, and part of that is in Iraq. State governors complain that their ability to deal with emergencies, such as tornadoes and hurricanes, is being compromised.

As matters stand, America can probably consider only limited and short-lived interventions, for instance to bring disaster relief. Given time, it could crank itself up for a major crisis. What seem out of the question for the foreseeable future are the medium-scale “wars of choice”.

For some time to come, the burden of projecting American power will fall even more heavily on the air force and navy. This may be enough to deter hostile governments, but insurgents and militias might be less worried. Air power alone cannot win a war. For now, Iran looks pretty safe from the threat of an Iraq-style ground invasion. Air bombardment may cause serious damage, but may not be enough to stop Iran's nuclear programme or unseat its clerical regime.

America's rivals

The dilemma for the Pentagon is how to improve its ability to fight today's insurgencies while preparing for tomorrow's conventional threats. Russia, enriched by high oil prices, is becoming more authoritarian at home and aggressive abroad. It still has a large arsenal of nuclear weapons. But its conventional forces are badly rusted. Large-scale exercises are a rarity for the conscript army, which in any case is heavily committed in Chechnya. The fleet does not put to sea in big numbers. Indeed, Russia's real means of projecting power is not its armed forces, but its sale of cheap advanced weaponry to other countries.

India, though growing fast, seems more interested in a strategic partnership with America rather than rivalry. China is the country that most worries the Pentagon. America says it encourages the peaceful rise of China as a “responsible stakeholder” in the world. But its communist rulers are investing heavily in a blue-water navy, which may one day include aircraft carriers, apparently to establish a defensive

perimeter deep in the Pacific along a chain of islands that runs from Japan to Guam and Papua. China is also modernising its nuclear arsenal.

For the moment the Chinese seem interested mainly in regional dominance, particularly keeping America at bay in any future conflict over Taiwan. They are emphasising “asymmetrical” means designed to blunt America's technological superiority: hoping to deny America the use of the seas with long-range anti-ship missiles and submarines, paralyse its highly computerised forces through cyber-warfare and neutralise spy and communications satellites. In January, China tested an anti-satellite missile. Its defence budget is thought to be expanding by around 12% a year, though its real size is the subject of conjecture. According to the Stockholm International Peace Research Institute, China last year overtook Japan to become the world's fourth-largest defence spender, after America, Britain and France.

This military expansion is made possible by startling economic growth. China's GDP now surpasses that of Britain or France. According to Goldman Sachs, China will overtake America around 2027 and become by far the world's biggest economy by 2050 (see chart 3). Even now, it is helping to prop up the weak American dollar by buying large chunks of American debt. China is pushing America aside as the world's biggest exporter, and last year it produced more cars than the United States. Europe, too, poses challenges to America: London is vying to replace New York as the most important financial centre, and the euro has displaced the dollar as the main currency of the international bond market.

Infographics

The force of good example

Important as “hard” military power and economic might may be, these factors are not all that has made America a superpower or even a “hyperpower”, as the French once put it. The “soft power” of its open culture and liberal democracy has provided an attractive model and encouraged others to see the world America's way. It has allowed America to multiply its influence through an unrivalled network of alliances. It is politically and diplomatically—and in terms of moral standing—that America has been most damaged.

For about two years after the invasion of Iraq, the Bush administration could still find evidence to claim that its muscular unilateral military action, however controversial, had made the world safer, encouraged democracy in the Middle East and enhanced American power. The Taliban were gone; al-Qaeda was on the run; America had new military bases in Central Asia; Saddam Hussein was captured and Iraqis voted freely. Moreover, Libya gave up its weapons of mass destruction; Palestinians elected the moderate Mahmoud Abbas after the death of Yasser Arafat; Israel left Gaza; and Syria withdrew from Lebanon. Peaceful revolutions in Ukraine and Georgia brought new pro-Western leaders.

But as the situation in Iraq has worsened, many of these gains have been reversed. Russia denounces America's “diktat and imperialism”, talks of a new arms race, threatens oil and gas supplies to neighbours regarded as unfriendly, and says it wants to overturn the Western-inspired economic order. America is being rolled back from parts of Central Asia, while Ukraine is in turmoil.

In the Middle East, a defiant Iran is stoking the insurgency in Iraq (and possibly also in Afghanistan). Its Lebanese proxy, Hizbullah, survived Israel's military onslaught last year with greater prestige. The Taliban have stepped up their insurgency. Above all, al-Qaeda has reconstituted itself, and exploits Muslim resentment over the “war on terror” to recruit new followers to its global *jihad*.

Mr Bush has changed his ways. Instead of threatening to topple rogue regimes, his administration has re-opened a diplomatic dialogue of sorts with North Korea, Syria and, most recently, Iran. America has rediscovered multilateralism, not least to keep a united front in imposing limited sanctions on Iran.

The “forward strategy of freedom” intended to democratise the Middle East has stalled, not least because elections have worsened sectarian tensions in Iraq and brought Hamas to power in the Palestinian territories. “Will America stay strong? Yes,” says one senior marine. “But can it use its power? That's a different question.”

The dilemma for America is whether withdrawing from Iraq will restore America's strength or signal

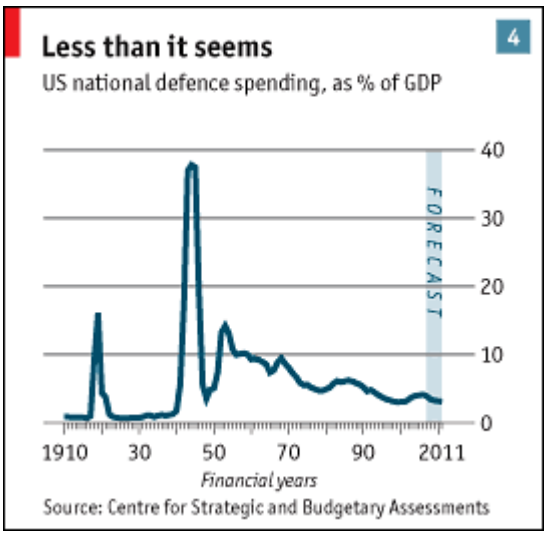
greater weakness. America's top brass, for the most part, want more time to try to turn things around in Iraq and avoid another Vietnam. Insurgencies take many years to defeat, they say, pointing to the British experience in Malaya. They are right. But a more apt parallel may now be Palestine, where the British gave up holding the ring between Arab and Jew and left them to it.

Still number one

Senior American officials console themselves with the thought that, whatever happens in Iraq, America will bounce back. Before long, perhaps after Mr Bush has left the White House, those complaining about America's overbearing power will come begging for its help.

America still spends roughly as much on defence as the rest of the world put together (see chart 2), and remains the only country able to project military power globally. Next year's budget request for $623 billion ("a gargantuan sum", according to one Pentagon official) represents 4% of GDP, which is low by historical standards (see chart 4). Military commanders often say that "the nation is not at war; the military is at war"; that is, the American public is not yet making real sacrifices. Taxes remain low, while the casualties are moderate enough not to be greatly felt, particularly by the urban elite. America has ample reserves to defend its global role and, Mr Krepinevich argues, potential rivals also have weaknesses. European countries are rich, but for the most part they are unwilling to spend money on military power; Russia's production of oil and gas is declining, and its population is in a demographic death-spiral; China may yet undergo internal upheavals that could disrupt its economy.

Infographics



Robert Kagan, a prominent commentator, is confident that the American-dominated "unipolar" world will endure. America has weathered worse disasters than Iraq, he says, not least soon after victory in the second world war, when the Soviet Union developed the hydrogen bomb and communists took power in China. Certainly America faces stronger regional antagonists, but none is yet competing for global supremacy, whether alone or in concert. If anything, many states want America's help to "balance" a rising China and a growling Russia. "A superpower can lose a war—in Vietnam or in Iraq—without ceasing to be a superpower," says Mr Kagan, "so long as the American public continues to support American predominance, and so long as potential challengers inspire more fear than sympathy among their neighbours."

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The Democrats

Harry's and Nancy's mixed half-year

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From The Economist print edition

AP

After six months in charge of Congress, the Democrats have passed only one important law but have applied welcome scrutiny to the executive branch

DICK CHENEY, the vice-president, claims that his office is not “an entity within the executive branch”, and therefore not subject to the rules concerning the proper care of secret documents. Six years ago, he rebuffed a probe into his energy task-force on the ground that it “would unconstitutionally interfere with the functioning of the executive branch”. Zen masters can doubtless see how a man can be both part of the executive and not part of it. Everyone else is grateful to Henry Waxman, the Democratic chairman of the House oversight committee, for exposing the absurd rationale for Mr Cheney's compulsive secrecy.

In November last year the Democrats trounced the Republicans to capture both chambers of Congress. On January 4th Nancy Pelosi, the top Democrat in the House of Representatives, celebrated her elevation to the speakership with the same prayer Margaret Thatcher used when she first became prime minister of the United Kingdom: “Where there is darkness, may we bring light. Where there is hatred, may we bring love. And where there is despair, may we bring hope.” Mrs Pelosi and her fellow Democrats have made some progress on the first of these, but not much on the other two.

In the six months that the Democrats have been in charge, they have energetically shone torches into White House nooks the previous, Republican-controlled Congress was content to leave dark. Besides chivvying Mr Cheney, the new Congress has investigated slipshod planning for the occupation of Iraq and the woeful treatment of injured veterans. It has subpoenaed the White House for documents about warrantless wiretapping, and grilled the attorney-general, Alberto Gonzales, about alleged politically-motivated sackings. Mr Gonzales still has his job, though. So does Mr Cheney.

Yet all this prodding keeps the administration on its toes. And so do efforts by the new Congress to influence the campaign in Iraq. The Democrats owe their majority in large part to war-weariness. Many of their supporters thought they would pull American troops out of Iraq. They have not. They could have done so, by refusing Mr Bush the funds to carry on fighting. But that would have shifted to the Democrats the blame for the carnage that would probably follow a sudden withdrawal.

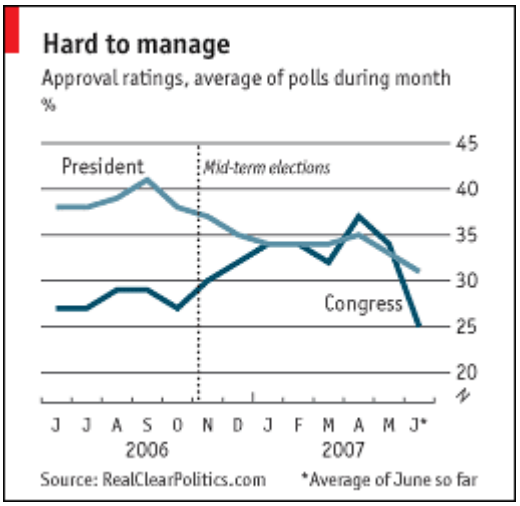
Instead, Ms Pelosi and her Senate counterpart, Harry Reid, sent President George Bush a war budget that included a timetable for withdrawal, knowing he would veto it. Their point made, they sent him another bill, without a timetable, that will fund the war until September. The bill also included benchmarks that the Iraqi government must meet if it is to continue receiving non-military aid. It was far short of what the anti-war movement wanted, but it keeps Mr Bush on a shorter leash than he would like.

What else has the 110th Congress accomplished? Of the Democrats' campaign promises, the meatiest one so far enacted is an increase in the federal minimum wage from $5.15 to $7.25 an hour, which is widely popular and will benefit some Americans while perhaps throwing others out of work. The Democrats have also tightened up rules about lawmakers accepting gifts from lobbyists, although Ms Pelosi undermined her own anti-corruption crusade by trying unsuccessfully to place an ethically-challenged ally in the number-two job in the House.

Other pledges have been blocked, delayed or watered down. A bill to allow the government to negotiate directly with drug companies to reduce prices passed through the House but stalled in the Senate. An attempt to fund foetal stem-cell research was vetoed by Mr Bush. Bills to provide cheaper student loans and implement the recommendations of the 9/11 Commission are grinding their way through the legislative process slowly.

Some big business is under way. Last week the Senate passed a substantial but flawed energy bill, which imposed tougher fuel-efficiency standards on cars but failed to consider a carbon tax or a cap-and-trade system. It also banned “price-gouging” by oil firms, a practice that exists only in Democrats' imaginations. The House version of the bill has yet to be revealed, so all this could change.

This week the Senate revived a bipartisan attempt to fix America's immigration system. Reformers want to curb illegal immigration but also to allow illegal immigrants who are already in the country swift legalisation and a path to becoming citizens. Opponents of the bill, mostly Republicans who decry it as an “amnesty”, nearly killed it earlier this month and were hoping to do so for real as *The Economist* went to press. After a quarter of its term, some lament that this Congress has done very little. That is too harsh. America's lawmaking process is designed to be slow and deliberative. And a Congress should not be measured merely by the number of laws it passes. David Boaz of the Cato Institute, a libertarian think-tank, argues that divided government is actually working quite well, since each side curbs the other's excesses. “The Democrats are discovering oversight and the president is discovering his veto pen,” he says. That is probably helping to restrain spending, at least for the time being.



But still, neither side shows the slightest appetite for reforming Medicare (health care for the elderly) or Social Security (public pensions), the two entitlement programmes that will bust the budget when the baby-boomers retire. And Americans are hardly enthused about their new Congress. At 25%, its approval rating is now even lower than Mr Bush's.

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Mayors

Leading by example

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From The Economist print edition

Why mayors are becoming more powerful outside their cities

THE mayors who gathered in a Los Angeles hotel for their annual chin-wag last weekend did their best to appear unimportant. They debated pointless resolutions, including one to eliminate nuclear, biological and chemical warfare throughout the world. They complained that the federal government wasn't giving them enough money. They applauded Hillary Clinton, the Democratic front-runner in the 2008 presidential campaign, when she told them that “cities and their mayors have been invisible to Washington”.

Such self-flagellation is rather odd, because mayors have seldom been more prominent in national or state politics. Rudy Giuliani, a former mayor of New York, leads the Republican field in the 2008 race. Michael Bloomberg, his successor, may run as an independent candidate. Maryland and Pennsylvania are governed by former city mayors. And Antonio Villaraigosa of Los Angeles is touted as a future governor of California.

This is a striking change. Being mayor of an American city has traditionally had its rewards (some of them ill-gotten), but until recently it was a dead-end job. Only three presidents ever ran cities, none among the ten biggest of their day; the last ex-mayor to become president was Calvin Coolidge in the 1920s, and he was also an ex-governor. Indeed, the bigger the city, the more abbreviated the subsequent career. The last year a mayor of New York was elected state governor was 1869.

That such a drought seems likely to break soon is thanks partly to Mr Giuliani. As he has been reminding Republican crowds, Mr Giuliani rescued New York twice—from high crime in the mid-1990s and from al-Qaeda in 2001. More important, perhaps, his most impressive moments coincided with spells of paralysis in the federal government. Almost single-handedly, he made city government seem glamorous and efficient.

These days mayors seldom tackle an issue of national significance without pointing out how incompetent the federal response has been. Climate change is an especially fashionable stick with which to beat Washington. Two years ago, as the Kyoto protocol went into effect without America, Seattle's mayor called on other cities to reduce greenhouse-gas emissions by 7%—the same cut that would have been required of the nation. More than 500 have since signed the “cool mayors” agreement. Mr Bloomberg, for his part, has signed up more than 200 mayors for his gun-control alliance.

Ironically, mayors' reputations have also been helped by the dearth of federal cash that they complain about. Before revenue-sharing ceased in the 1980s they had a richly deserved reputation as beggars. Since then the shrewder mayors have turned themselves into salesmen. They lobby for corporate headquarters and sports teams and try to lure visitors to spruced-up city centres. John Hickenlooper's background as owner of a pub in downtown Denver prepared him well for such a role as mayor there.

Finally, mayors are seeking higher office because they are forced to. During a burst of populist term-limiting in the 1990s many were restricted to eight years in office, as were most governors and some state legislators. In California, which has some of America's stingiest term limits, ambitious politicians like Mr Villaraigosa have no choice but to cycle through city and state positions. That is good for their careers. They build reputations as they go, never becoming too strongly associated with the eccentric ways of their cities or the vicious partisanship of state politics.

The improvement in mayors' political fortunes is long overdue, yet it is happening at an odd time. Some big cities are shrinking, and even growing ones such as Denver and Los Angeles are not adding people nearly as quickly as surrounding suburbs are. In 1950 one in 19 Americans lived in New York; now one in 36 do. Big-city mayors are coming in from the cold just as big cities become less important.

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Iowa

Lend me your ears

Jun 28th 2007 | DES MOINES AND OTTUMWA
From The Economist print edition

In America's corn belt, the election battle already rages

AMERICA may not be electing its next president until November next year, but it doesn't seem that way in Iowa. During a 48-hour visit last week, *The Economist* found no fewer than four of the 18 current candidates in this agricultural state of a mere 3m souls. The reason, of course, is the Iowa caucuses, the first of all the primaries and caucuses which will sift out the two main parties' contenders. The vote will be held no later than January 14th, and possibly two weeks or more earlier. So the opening shot in the presidential election is now only six months away.

But does Iowa really matter any more? Many people think it shouldn't. Iowa's population is a mere 1% of America's and much whiter (94% versus a national average of 80%) and more rural. Its caucuses are open only to registered voters of the two parties. In all, only about 200,000-250,000 people are expected to turn out there. That is one big reason why some 22 states, including New York and California, have resolved to hold their primaries on February 5th: they are fed up with so tiny a tail wagging so large a dog.

So will the farmers' voices be drowned out? On the Republican side, there is evidence to support this view. Despite a brief and highly stage-managed appearance in Des Moines, the state capital, last week, Rudy Giuliani is not expending much effort in Iowa. Nor is his current main rival, Senator John McCain. Campaigning in Iowa is time-consuming: the locals are an awkward lot who relish meeting their candidates in the flesh, so a solid Iowa run traditionally requires a visit to all or almost all of the state's 99 counties. This is no small matter. Senator Sam Brownback, another Republican hopeful, was busy making seven stump speeches a day for four days last week, each in a different county with lengthy bus-rides in between. Messrs Giuliani and McCain could be forgiven for thinking their time better spent elsewhere.

For the Republicans' lesser lights like Mr Brownback, though, Iowa is a last chance. They lack the resources to campaign across the big early states. But a good showing in Iowa, especially if followed up by a good result in Nevada or New Hampshire, the states due to be the next to vote, could provide “momentum” and a final chance to raise money for and win votes on February 5th.

Quite possibly, the field will be brutally narrowed a lot sooner than that. On August 11th the Republicans are holding their “straw poll” in Ames, 35 miles (58km) north of Des Moines. Some 30,000 Republican voters are being bused in from around the state for a day of parties, speeches and a vote. Mr McCain and Mr Giuliani have both already bowed out: but anyone who does unexpectedly well will survive a little longer, while anyone who bombs there will probably be finished. “I gotta win the straw poll,” admits Tommy Thompson, an engaging ex-health secretary and ex-governor, speaking at a supper meeting in the bosky garden of a supporter in a suburb of Des Moines. But the most likely winner of the straw poll is Mitt Romney, a successful businessman who governed Massachusetts well but is running a poor third nationally. A big win in Iowa could transform his campaign.

Over on the Democratic side, it is quite a different story. The three main candidates, Senator Hillary Clinton, Senator Barack Obama and ex-Senator John Edwards, are practically living in Iowa. For Messrs Edwards and Obama, Iowa may represent nothing less than survival: of the three early states, Iowa is where their chances look fairest. Anyone going into February 5th without having won at least one of the three would invite disaster.

Mrs Clinton's objective is different. Polls show that she has a chance of sweeping all three early states, which would give her excellent momentum. So she has established 12 field offices throughout Iowa, enlisted the enthusiastic support of Iowa's popular former governor, Tom Vilsack, and is spending every available weekend there. On July 4th she will bring her biggest gun to bear: it will be the first time in the race that she and Bill Clinton have campaigned together.

Mrs Clinton's most dangerous rival remains Mr Obama, who has so far not performed well in Iowa. Democratic voters in this fairly conservative state are often linked to unions in the less corn-dependent eastern counties, and Mr Edwards and Mrs Clinton score better with union workers than Mr Obama does.

Last week he was bravely trying his hand in Ottumwa, in the south-east, home to a John Deere factory and a big meat-packing plant. The turnout was impressive, the audience thrilled to see him, but the man himself seemed oddly unable to catch the moment. He gave his usual spiel about the need for hope and the interconnectedness of people. His audience seemed more interested in talking about illegal immigrants and animal welfare.

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Judiciary

Judges behaving badly

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From The Economist print edition

Low pay and partisan elections are threatening judicial integrity

A $54m lawsuit over a pair of pinstriped trousers that went missing from a Washington, DC, cleaners was thrown out by a judge this week. It had attracted worldwide ridicule. The fact that the case was brought, not by a random loony, but by a former judge has added to the sense that something is wrong not just with America's litigation laws, but with the kind of men and women Americans choose to sit in judgment over them.

A whole series of judicial misdemeanours, ranging from the titillating to the outrageous, has emerged over the past year. Take the Florida state judge, John Sloop, who was ousted after complaints about his "rude and abusive" behaviour. This included an order to strip-search and jail 11 defendants for arriving late in traffic court after being misdirected. Or the Californian judge, José Velasquez, sacked in April for a plethora of misconduct, including extending the sentences of defendants who dared question his rulings.

Then there was the Albany city judge, William Carter, in New York, censored for his "utterly inexcusable" conduct after jumping down from the bench during a trial, shedding his robes and apparently challenging a defendant to a fist-fight. Another time, he suggested that the police "thump the shit out" of an allegedly disrespectful defendant. Mr Carter wasn't carrying a gun; many judges now do. In Florida, Charles Greene, chief criminal judge in Broward County, had to step down after describing a trial for attempted murder involving minority defendants and witnesses as "NHI" (No Humans Involved). Then there are the sexual peccadilloes. In Colorado, a (male) judge resigned after admitting having sex with a (female) prosecutor in his chambers. In California, a former judge was jailed for 27 months for downloading child pornography. And in Oklahoma Donald Thompson, a judge for more than 20 years, was jailed for four years for indecent exposure and using a "penis pump" to masturbate during trials.

More serious are the cases of corruption. On June 5th Gerald Garson, a former judge in Brooklyn, New York, was jailed for taking bribes to rig divorce cases. Another judge was convicted of accepting money to refer clients to a particular lawyer. Rumours of buying and selling of judgeships in the district abound. At one time, one in ten Brooklyn judges were said to be under investigation for sleaze.

"To distrust the judiciary," said Honoré de Balzac, "marks the beginning of the end of society." In Britain, judges are one of the most respected groups. But in America they tend to be held in low esteem, particularly at state level. For this many people blame low pay and the fact that judges are elected. In 39 states, some or all judges are elected for fixed terms. Federal judges, usually held in much higher esteem, are appointed on merit for life—as in Britain.

Most states allow judicial candidates to raise campaign funds. Huge sums are often involved, leading to inevitable suspicions that, once on the bench, judges will pass judgments that favour their benefactors. In 2004 the two candidates in one Illinois district (with a population of just 1.3m) raised a staggering $9.4m between them. Some of the states with the highest levels of campaign spending—Texas, Louisiana and Alabama—are also those whose judges are most criticised.

In the past, judicial candidates were banned from discussing controversial legal or political issues on the campaign trail. But in 2002 the Supreme Court ruled such bans to be unconstitutional, leading candidates to advertise freely their views on abortion and suchlike. Personal attacks have also become more common. Indeed, Sandra Day O'Connor, a former Supreme Court justice, fears that judicial elections have turned into "political prize-fights, where partisans and special interests seek to install judges who will answer to them instead of the law and the constitution."

The meagre salaries of judges, whether at state or federal level, do not help raise standards either. Federal judges have not had a real pay rise for 17 years; a district court judge earns $165,000 a year, about the same as a first-year associate in a top law firm. John Roberts, chief justice of the Supreme

Court, earns just $212,000—half the salary of England's top judge and one-fifth of the average income of a partner in the majority of America's 100 top-grossing law firms. Around 40 judges have left the federal bench over the past five years.

In his annual report to Congress in January, Mr Roberts said that the issue of judges' pay had reached “the level of a constitutional crisis”. It was threatening the judiciary's strength and independence. In February, Patrick Leahy, the Democratic chairman of the Senate Judiciary Committee, promised legislation to fix it within the current session. The judges are still waiting. Meanwhile, state judges in New York are preparing to sue the state for their first pay rise since 1999. The battle is joined.

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Weddings

The number of the feast

Jun 28th 2007
From The Economist print edition

Expect a bumper crop of matrimonials next week

JUNE 6th 2006 was a quiet day for weddings across the United States. Even Las Vegas—which calls itself the wedding capital of the world, with 113,000 wedding licences issued last year—had a tiny fraction of its usual business. The reason was the date: 06-06-06 or 666, the “number of the beast” in the book of Revelation.

By contrast, 07-07-07 looks set to be very busy for Vegas. Since the city was founded in 1905, all the sevens have lined up twice in a date. In 1907 Las Vegas was only a two-year-old baby and anyone laying a bet then was also breaking the law, as gambling was not legalised until 1931. The marketing business has moved on quite a bit since 1977, and now world-wide interest looks likely to mean a bumper weekend for the town.

Why seven is so lucky is unclear, though several religions make it so. The “Freemason's Encyclopaedia” devotes two full pages to its significance, and rolling seven in craps always wins. Whatever the reasons, the world's wedding and gambling centre is expecting one of its busiest-ever summer days, with bookings from both home and abroad already touching record levels.

According to Angus Bond of Virgin Holidays, chapels are selling wedding slots as early as 12.30am in order to fit as many ceremonies into the day as possible. The Venetian Resort Hotel Casino is expecting to raise its usual Saturday wedding count from 20 to, yes, 77, and has added four more venues to its existing three—Chapel, Gondola and Bridge—to achieve this. If you have only two guests, and don't mind a group wedding at 7pm, $1,777 will buy you a slot at the Mandalay Bay Resort and Casino, where later you can “Get Down tonight” and “Give it Up” to the R&B sounds of KC and the Sunshine Band.

It is not just lucky weddings that will draw people to Vegas on July 7th, of course. “There is a real belief that a lucky person will win big on the 7th. The casinos are expecting a busy day, especially on the slot machines,” says Mr Bond. Rumour has it that one of the big casinos will set one of its slot machines to pay out $1m on a 7-7-7-7 winning line.

The Ritz-Carlton, Lake Las Vegas has special deals for guests who are feeling lucky. Their two-day “Seven Ways of Wonderment” package, at $7,707, enables guests to stay on the seventh floor, enjoy a seven-course dinner, a $777 shopping spree and a 7am golf tee-time. Not ready to miss a trick, the five Wolfgang Puck Las Vegas restaurants have invented a cocktail in celebration of the day. The Strawberry Hardway (three sevens is known as the “hard way” to 21 in blackjack) has been concocted from tequila, lemon juice, syrup, strawberries, ice, balsamic cream and a dash of luck.

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Lexington

Out and proud parents

Jun 28th 2007
From The Economist print edition

Kevin Kallaugher

As tolerance spreads, gay life is becoming more suburban, contented and even dull

A FEW years ago, a Gay Pride parade passed The Simpsons' house in Springfield. “We're here! We're queer! Get used to it!” chanted the marchers. Little Lisa Simpson replied: “You do this every year. We *are* used to it.” As usual, the cartoon was a few steps ahead of real life. But only a few. The *New York Observer* recently published an article about gays who think Gay Pride marches are pointless, since the big battles for gay rights have already been won. (The title: “Goodbye, Mr Chaps”.) One non-marcher remarked: “I live in New York, and it's sort of like every day is Gay Pride Parade. I don't need this special day where I'm out of the closet.”

Perhaps it is no surprise that gays find a hip city like New York hospitable. But two sets of data suggest that America as a whole is becoming steadily more tolerant. First, opinion polls show that homophobia has receded almost as far as Homer Simpson's hairline. As recently as 1982, only 34% of Americans thought homosexuality should be considered an acceptable alternative lifestyle. Now, 57% do. Since young Americans are far more relaxed about homosexuality than their elders—three-quarters of 18-34-year-olds think it is OK to be gay, whereas half of those over 55 think it is not—this trend is likely to continue. This year was also the first since Gallup started asking the question that a majority of Americans have not said that homosexual relations are morally wrong. And a hefty 89% think that gays should have equal rights in terms of job opportunities. If that strikes you as no big deal, recall that a total ban on gays working for the federal government was repealed only in 1975.

Second, and more subtly, one can look at demography. Gary Gates, a Californian academic, has been mining census data to determine where gays live in America. He observes several trends. First, the number of openly gay households is growing five times faster than the population as a whole. The last full census, in 2000, counted nearly 600,000 same-sex couples. Five years later, the American Community Survey (in which the Census Bureau quizzes a statistically representative sample of 1.4m households) estimated that that number had increased by 30%, to 777,000. Mr Gates reckons the bulk of the increase is because as tolerance spreads, more gay couples are willing to be counted.

The increase was most pronounced in the Midwest, with Wisconsin showing an 81% jump in the number of same-sex couples and Minnesota, Nebraska, Kansas, Ohio, Iowa, Missouri and Indiana also among the ten fastest-growing states in this respect. What this means, perhaps, is that gay America is becoming more like Middle America. “Much of the stereotype around gays is a stereotype of urban white gay men,” says Mr Gates. “The gay community is becoming less like that, and more like the population in general.”

Gay couples are still more likely than straight ones to live in cities, but the gap is smaller than popularly believed, and closing. In 1990, 92% of gay couples but only 77% of American households were in what the Census Bureau calls “urban clusters”. By 2000, the gay figure had fallen to 84% while the proportion for households in general had risen to 80%, a striking convergence.

Virtually normal

San Francisco is great if you are young, single and looking for a party. But if you want to settle down with a partner, the suburbs and the heartland beckon. Gays who have children—and a quarter of gay couples do—gravitate towards them for the same reasons that straight parents do: better schools, bigger gardens, peace and quiet. Mark Strasser, for example, lives with his male partner and their two children in Columbus, Ohio. He says they encounter no hostility eating out as a gay couple or picking up the children from their private school. He has to rack his memory for the last time anyone called him anything nasty for being gay. “That would have been in the late 1980s, I think,” he says. His employer, a private university, offers the same health insurance to employees' gay partners as to spouses (as did most Fortune 500 companies, for the first time, last year).

Mr Strasser has worries, of course. Ohio is one of 26 states with a recent constitutional amendment barring same-sex marriage. Mr Strasser wonders whether a public school would recognise that his children have two fathers, or if a hospital would allow both of them to visit if one of their children fell ill. This is a serious matter. Only Massachusetts allows same-sex marriage, although six other states have allowed civil unions that are marriages in all but name, and a law allowing full marriage rights passed through the lower house of New York's state legislature on June 19th. Most Americans are still uncomfortable about letting gays tie the knot, but support for the idea has risen from 27% in 1996 to 46% this year.

Jonathan Rauch of the Brookings Institution argues that the campaign for same-sex marriage was spurred in part by AIDS. For gay Americans, the epidemic put a damper on exuberant promiscuity and highlighted the benefits of loving partnership. Although the last state anti-sodomy laws were struck down only in 2003, sexual liberation is now taken for granted, argues Paul Varnell, a writer. “Far from being radicals of any sort, most of us are just plain ol' bourgeois,” writes Mr Varnell. “How much more bourgeois can you be than wanting to marry the person you love and wanting to serve in the military?”

The kind of gay activists who think you can't be authentically gay unless you are permanently in opposition to the mainstream find the prospect of gay assimilation appalling. So does the religious right. A black preacher named Wellington Boone, for example, has circulated a pamphlet entitled “The Rape of the Civil Rights Movement: How Sodomites Are Using Civil Rights Rhetoric to Advance Their Preference for Sexual Perversion”. But he is howling at the incoming tide.

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Brazil

Lazy, hazy days for lucky Lula

Jun 28th 2007 | SÃO PAULO
From The Economist print edition

Better times sap the will to reform, among government and opposition alike

Peter Schrank

Get article background

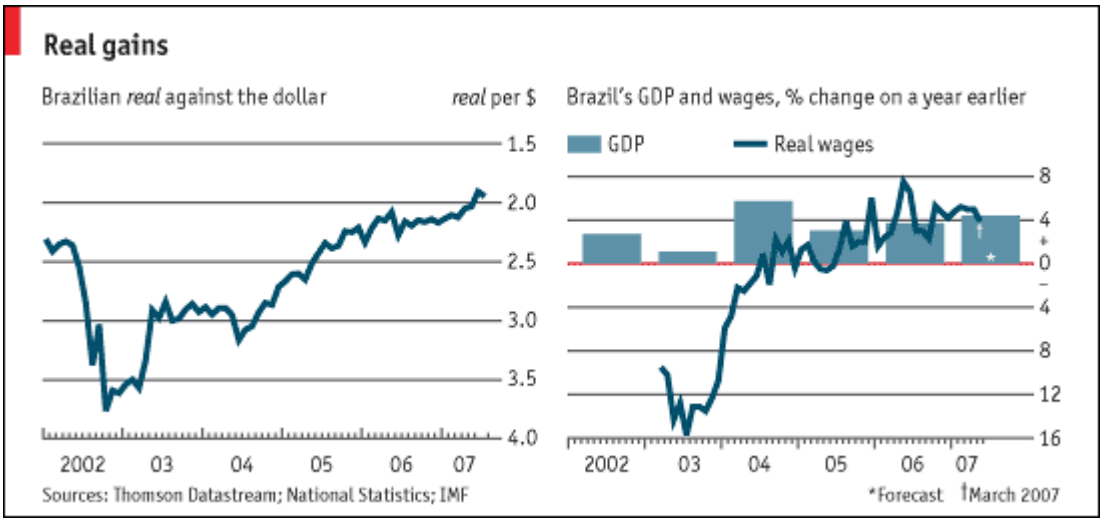
THESE are strange times in Brazil. Every morning, the country's main newspapers bring fresh instalments in a slew of corruption scandals lapping around the government of President Luiz Inácio Lula da Silva. The latest one involves the president of the senate, Renan Calheiros, a Lula ally. He faces widespread calls to resign over allegations that a lobbyist for a construction firm made regular payments to a journalist with whom he had an affair and a child. In another case, involving illegal slot-machines, federal police questioned one of Lula's brothers over alleged influence-peddling.

The government seems trapped in torpidity. Six months into his second term, Lula has just completed his cabinet, adding a 37th minister—one for “strategic planning”. But what are all these ministers for? The government's agenda is unambitious, and its reaction to events often tardy and fumbling. Take the chaos that has gripped Brazil's airports since October as a result of go-slows by disgruntled air-traffic controllers. Marta Suplicy, the tourism minister, seemed to sum up the official stance when, to much outrage, she suggested that travellers should “relax and enjoy” the long delays. On June 22nd the government finally sacked 14 controllers—an action it could have taken months ago.

Brazilians often gripe that their politicians, ensconced in Brasília, live in pampered isolation from everyday realities. Yet perhaps it is the newspapers, for all the polished competence of their investigations, which are living in a bubble. They are read by the few: *Folha de São Paulo*, the biggest-selling daily, shifts only 300,000 copies in a country of 190m people. Meanwhile, the average Brazilian is rather content, less interested in the television news than the soap opera that follows it. Scandals notwithstanding, the president is hugely popular. In São Paulo's gritty periphery “everyone loves Lula,” says Afonso Gonçalves, who owns a small supermarket in the suburb of São Bernardo, where the president was once a trade-union leader. “He focused on the poor. He's the people's president.”

It is not hard to spot the reasons for the public mood. In many ways, Brazil is doing better than it has for a generation. Inflation is low and economic growth is steadily rising. Aloizio Mercadante, who chairs the Senate's economic-affairs committee, reels off many other positive numbers: the current account is in surplus; the fall in the public debt is ahead of target; the Central Bank's benchmark interest rate has fallen from 27.6% in 2002 to 12% today; total wages in the economy have grown by 8% over the past

year; investment is up 7% over the same period; and consumption has risen for 15 consecutive quarters.



Brazil is benefiting hugely from high world prices for its commodity exports and abundant global liquidity, as well as from the economic reforms of Lula's predecessor, Fernando Henrique Cardoso. “Lula is a lucky man,” says Maílson da Nóbrega, a former finance minister. But he adds that Lula has contributed to his own good fortune: he kept Mr Cardoso's fiscal and monetary policies and gave the Central Bank operational independence. By not hesitating to raise interest rates when inflation threatened, the bank's governor, Henrique Meirelles, has won investors' trust. That, together with the export boom, has brought a steady appreciation of the real (see chart).

The strong currency has helped to boost purchasing power, especially that of poorer Brazilians for whom lower food prices are a particular boon (as is a government anti-poverty programme that reaches 11m families). But the currency's strength has some industrialists grumbling; the real is overvalued by 20%, argues Paulo Skaf, the head of the São Paulo federation of industry. Some Brazilian firms have responded by opening factories abroad, from China to Argentina. The government this month offered cheap credit to producers of shoes, textiles and furniture who are struggling in the face of Chinese competition.

Mr Skaf and others argue that the real's strength underlines the case for structural reforms—of taxes, pension, labour laws and infrastructure—in order to cut the cost of doing business. Brazil is still growing more slowly than the world economy. Without reform, the sustainable rate of growth is no more than 4% a year, many economists say. As Mr Cardoso puts it: “we have to compete not with our past but with our competitors.”

The government's response is, in essence, that it does not believe in reform for reform's sake. Franklin Martins, the president's press secretary, argues that Brazil can grow at up to 5.5% a year without further reforms. Any change to the labour laws that would take away rights from those Brazilians who work in the formal economy is “not a priority”, he says. Pension reform is, but only for new workers. He adds that tax reform may be possible in two years' time, when the government should need less money to pay its debts.

This may make for mediocre economics but it is astute politics. Even the opposition has lost much of its reformist impulse. Mr Cardoso's Party of Brazilian Social Democracy (PSDB) has been disarmed by Lula's adoption of many of its economic and social policies. Its former coalition partner, the (conservative) Party of the Liberal Front, has changed its name to the Democrats as part of a stampede for the middle ground of Brazilian politics. The opposition's attempt to make corruption the issue in last year's presidential election rebounded: most Brazilians like and trust Lula, if not all of his followers. Besides, as life improves, people are paying less attention to corruption and the legal formalities of public life, laments Mr Cardoso.

In the medium term, the chance of further reform may depend on the PSDB, which under Mr Cardoso laid the foundations of economic stability and a stronger democracy in the 1990s. The party has two plausible candidates for the next presidential election in 2010 in José Serra and Aécio Neves, respectively the governors of São Paulo and Minas Gerais. But it now lacks a programme. “We have a good chance to be a governing party again, but to do what?” asks Mr Cardoso. He says the PSDB needs to be less scared of advocating modernisation, reform and further privatisation.

Lula's Workers' Party lacks a strong candidate to follow the president, who under the constitution cannot run in 2010 (but might be able to in 2014). For now, however, Lula stands supreme in Brazil. Rather than governing, he reigns above party while “Brazil is on automatic pilot,” says Gaudêncio Torquato, a political consultant in São Paulo. Unlike some of its would-be air travellers, at least it has taken off.

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Chile and Peru

Neighbours, but not yet friends

Jun 28th 2007 | LIMA AND SANTIAGO
From The Economist print edition

A wary rapprochement

Get article background

TRADE between their countries was thriving even before the governments of Chile and Peru signed a free-trade agreement last year with an eye to boosting their combined exports to Asia. Chilean firms run Peru's main airline, department stores and chain of chemists. Peruvian chefs run some of the best restaurants in Chile's capital, Santiago. In many ways, these two neighbours are drawing closer. But the past continues to haunt them.

In a war in the late 19th century, Chile defeated Bolivia and its ally, Peru, seizing from them what is today its copper-rich northern territory. Bolivia continues to clamour for its lost outlet to the sea. Apart from a minor quibble over the land border, Peru makes no such claim. But it does dispute its southern maritime boundary.

Chile argues that this was fixed as running due west by treaty in the 1950s. These were just fishing agreements, retorts Peru. It takes the land border's final seaward stretch, which runs in a south-westerly direction as fixed by an earlier treaty, and projects this into the Pacific. Between these two lines lies a large, fish-rich triangle.

In tackling this issue, both governments must deal with national pride and jingoistic media. Peru's previous president, Alejandro Toledo, sometimes yielded to such pressures. Alan García, his successor, has so far largely resisted them.

That is not always easy. In April Ollanta Humala, a nationalist former army officer who lost to Mr García in a presidential election last year, announced that he would lead a protest march to the border. Police halted the march well inside Peruvian territory. Mr García responded by saying that he proposed to ask the International Court of Justice in The Hague to rule on the maritime border.

Chile protested, but officials in Santiago privately welcome the move. The court will take years to rule, and the referral may draw some of the political sting from the issue. There are other signs of goodwill. In March poets from both countries held a reading aboard a captured Peruvian battleship moored as a museum in a Chilean port. Chile's government says it is awaiting a suitable moment to return part of Peru's national library, seized in the war.

In public, Mr García and Chile's president, Michelle Bachelet, have been ostentatiously friendly. But progress on an agenda of confidence-building measures drawn up last year has been patchy. Chile complains that Peru has yet to implement an agreement to standardise accounts of military spending. Relations could be upset if Chile's Supreme Court throws out Peru's request to extradite Alberto Fujimori, a former president who faces corruption and human-rights charges.

Paradoxically, the thorniest outstanding issue involves Bolivia. Ms Bachelet has been friendly to its president, Evo Morales. In theory, a grand bargain beckons in which energy-short Chile would grant Bolivia use of a port and transport corridor in return for access to its large reserves of natural gas. The problem is that the most practical option for such a corridor would be in former Peruvian territory. And that is something Peruvian governments have found hard to swallow.

In the 1970s, when both Peru and Chile were ruled by military governments, they came close to war. That now seems unthinkable. They are no longer enemies. But it may take another generation before they become friends.

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Venezuela

It's our oil

Jun 28th 2007 | CARACAS
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Exeunt Exxon and Conoco

Get article background

WHEN Venezuela's government announced this week that two American oil giants, Exxon Mobil and ConocoPhilips, would walk away from their large investment in the Orinoco heavy-oil belt rather than accept tough new contract terms, officials presented it as the recovery of sovereignty over another slice of the country's all-important oil industry. Some other Venezuelans saw a government blunder that could accelerate the decline of the state oil company, Petróleos de Venezuela (PDVSA). Either way, the impact of the walkout may not be immediate.

The companies were among those attracted to Venezuela in the 1990s, under the terms of an oil "opening" that the leftist government of President Hugo Chávez has now pronounced shut. In common with other big oil producers, Venezuela has substantially raised its tax take from private oil producers as its bargaining power has risen along with the oil price. Now it has also completed the process of obliging all foreign companies to accept minority shares in joint ventures with PDVSA.

Seven of the 11 companies operating in the Orinoco belt, including Chevron of the United States, Britain's BP and France's Total, agreed to the new terms. Along with Exxon and Conoco, Petro-Canada and Opic, a Taiwanese company, did not. Venezuela will pay compensation, possibly running into billions of dollars. Conoco said it had "preserved all legal rights including international arbitration".

"For us, there is no cost," insisted Rafael Ramírez, the oil minister who also acts as chairman of PDVSA. "There is an important gain: national sovereignty."

Venezuelan officials claim that the Orinoco belt contains some 250 billion barrels of oil—an amount similar to Saudi Arabia's reserves. But extracting it is expensive and complicated. Private companies were originally invited in, on favourable terms, because PDVSA had neither the technology nor the capital to turn what was once considered bitumen into synthetic crude. Some 500,000 barrels per day now come from the Orinoco.

Oil industry sources say that Venezuela's total output has fallen to 2.3m b/d (though the government claims it is 3.2m b/d). That is mainly because of the shortcomings of PDVSA, which sacked most of its qualified staff after a two-month strike in 2002-03 and whose investment budget has been used as a cash-cow for social programmes by Mr Chávez.

Will Exxon and Conoco's departure cause a further fall in output? Some industry analysts reckon it will. Others are not so sure. Such is the hunger of oil companies for access to reserves that others may step in on the government's terms. Even if they do not, PDVSA can buy the necessary expertise from specialist service companies, argues Mazar al-Shereidah, an economist at the Central University of Venezuela.

Nevertheless, some Venezuelans worry that their country's oil industry is going the same way as that of Iran, whose government is one of Mr Chávez's closest allies. This week, as Venezuela's president was due to visit Tehran on a tour that also takes him to Russia and Belarus, Iran imposed petrol rationing. Admittedly, Iran faces sanctions, and Venezuela does not. But national sovereignty does not automatically fill the tank.

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Canada's oil sands

Boomtown on a bender

Jun 28th 2007 | FORT MCMURRAY
From The Economist print edition

The downside of explosive growth in northern Alberta

WITH C$36 billion ($25 billion) invested so far in its oil sands and another C$45 billion expected over the next decade, the Canadian province of Alberta is booming. Workers have flocked in, lured by wages of up to C$120,000 a year. The once sleepy town of Fort McMurray, at the centre of the bonanza, boasts a crowded casino and a busy airport. But big money has brought big problems, including overstretched infrastructure and soaring drug use.

The town's population has grown by 9% a year for the past six years, says Sheldon Germain, the deputy mayor. In all directions, swampy forests are giving way to sprawling rows of clapboard houses that cost more than they would in the suburbs of Toronto.

The local authorities are struggling to cope. They cannot approve any more buildings in the town centre, Mr Germain says, because the sewerage system is overflowing. Doctors at the hospital complain of being overwhelmed; housing costs deter new recruits. The sole road connecting Fort McMurray with the rest of the province is crowded and deadly. The only way for the town to raise revenue to tackle these problems is to increase property taxes. But locals complain that they already suffer from exorbitant local prices, and want the oil companies to foot the bill.

Crime is another problem. Many of the thousands of workers who live in barrack-like accommodation at nearby mines and construction sites come to town at weekends, to drink a beer or ten, brawl, and buy sex and drugs. “This town is awash in cocaine,” says one long-time resident. Marijuana, crack and crystal meth are also widely used. Drug abuse in the northern oil patch is more than four times the provincial average.

According to Harold Hoffman, a specialist in occupational medicine in Edmonton, about 40% of the workers test positive for cocaine or marijuana in job screening or post-accident tests. Companies worry about lower productivity (due to absenteeism or sloppy work) caused by drug abuse, and the safety risk. On drilling rigs and in oil-sands mines a small mistake can easily result in injury or death. Some experts believe Alberta's rising job-site accident rate (up 17% in two years to 180,000 cases in 2006) is partly due to drug abuse.

Most of the biggest companies conduct drug tests before hiring, as well as after any accident. But many workers have learned to get around these with synthetic-urine kits from drug-paraphernalia shops. Many smaller contractors prefer to turn a blind eye for fear of losing workers in such a tight labour market. Lawrence Derry, an addiction expert at the University of Alberta, says that one contractor told him that “if I brought in drug testing, I'd lose half my crew—they'd go right over to my competitor.”

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Chinese politics

Democracy? Hu needs it

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Ahead of its congress later this year, the Chinese Communist Party is tolerating a surprisingly wide-ranging debate about political reform

David Simonds

HAS Hu Jintao, China's president and Communist Party chief, seen the political light? Since he assumed leadership of the party nearly five years ago, he has shown little interest in making China more democratic. But in a much-publicised speech this week, he acknowledged the growing public demand for a say in politics. Efforts to reform the country's political system, he said, should match these aspirations. Mr Hu did not say exactly how things should change. But in recent months he has tolerated an unusually open debate about the country's political options. Calls for a multiparty democracy remain taboo, but not much else.

In the speech Mr Hu said that, over the three decades since China began its “reform and opening up”, changes to China's political structure had proceeded in an “active and prudent way”. More accurately, they have been practically non-existent. Yet as Mr Hu prepares for a crucial five-yearly party congress around October he appears a bit more open to ideas.

His speech set clear boundaries. The party's leadership must be upheld; reform must adhere to the “correct political orientation”. This means no Western-style parliamentary democracy or balance of power between the executive, legislature and judiciary. But his reference to “political participation” suggests he faces some pressure to set a clearer agenda. He said scope for participation should be expanded, but in an “orderly” way.

Even within Mr Hu's constraints, liberal intellectuals in China see room for big changes. A newspaper article published last October in the normally staid municipal party organ, *Beijing Daily*, launched a debate about political reform among academics and party officials that still rumbles on. Its author, Yu Keping, a leading party researcher, argued that democracy was essential for China. *Study Times*, one of the party's leading theoretical journals, republished the piece under the titillating headline “Democracy is a Good Thing”.

The party press does not usually harp on the merits of democracy. But Mr Yu was careful to stay within permitted boundaries. Even Mr Hu himself had said in April 2006 during a trip to America that without democracy there could be no modernisation—a slogan first taken up in China in the late 1970s by political dissidents. But “democracy” in party-speak has a quite different meaning from the one understood by dissidents and Westerners. It certainly does not mean allowing organised opposition. Mr Yu did not define his terms.

However, in February this year a liberal-leaning monthly journal, *Yanhuang Chunqiu*, threw caution to the winds. It published an article by Xie Tao, a retired vice-president of Beijing's Renmin University, singing the praises of Sweden's Social Democratic Party as a model for China's Communist Party. Mr Xie did not mention multiparty systems explicitly. But he scorned the party's continuing reverence for the “utopian” ideal of communism and warned that it could be destroyed like the Chinese Nationalist Party in the 1940s if it failed to reform politically.

Mr Xie's article touched a raw nerve. Party organisations in some universities arranged symposiums to attack his views. Other official newspapers, including the party's main mouthpiece, the *People's Daily*, criticised European-style social democracy as unsuitable for China. But the debate has not stopped.

A journal controlled by the Ministry of Finance, the *Review of Economic Research*, recently devoted half of its 56 pages to an unusually detailed proposal for political change. The authors said this could be carried out over the next 20 years. The lead writer was Zhou Tianyong, a senior official at the Central Party School, a training centre and think-tank for top officials. Mr Zhou heads a team studying (with official approval) political-reform plans. It was careful to stress the need to maintain the party's monopoly on power. But its suggestions, if implemented, would transform China's politics.

One idea is for the party to give up its insistence that its 70m-odd members be atheists. Mr Hu might one day actually accept this. The party has begun to speak more positively about the role of religious groups in fostering a “harmonious society”. The researchers also called for sweeping cuts in the bureaucracy, including the elimination of two of the five tiers of government: the townships at the bottom level and prefectures in the middle. Tentative moves in this direction are already being carried out in some places. And in a recent shuffle of provincial and lower-level party leaderships, tens of thousands of posts at the level of deputy party-secretary have been eliminated.

But other ideas will be less palatable. The researchers suggested quicker moves to develop NGOs. The party makes noises about encouraging NGOs too, but in practice officials fear they might turn into opposition groups. The researchers proposed proper election campaigns for seats in the national legislature. These are now mostly filled by party appointees with no public discussion. The proposal suggested that the legislature itself, which is little more than a rubber stamp, should be slimmed to about 15% of its current size and allowed to engage in real debate. It also wanted officials, who now occupy about half of the legislature's seats, barred from serving as delegates. Party leaders would see this as a dangerous step down the slippery slope towards a separation of powers.

If Mr Hu does have any plans for political change, he is unlikely to make them public before he has sealed his grip on power at the party congress. It will be his first as party chief and the moment to install his preferred successors in top jobs. Herein lies a problem. If the party is sincere about democracy, many academics say it should begin by encouraging it within its own ranks. Mr Zhou's team advocates competitive elections for party posts, with candidates no longer proposed by higher-level organisations. So should Mr Hu and his would-be successors start campaigning? No rush. If Mr Hu wants democracy, he wants it the way Saint Augustine wanted chastity: not yet.

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Myanmar's Muslims

Unlikely sanctuary

Jun 28th 2007 | JINGHONG
From The Economist print edition

Huddled masses, yearning to be free and going to China

Get article background

AT FIRST glance, Yunnan would seem the sort of place a pious Muslim should avoid. AIDS is rampant in this province in south-western China and Beijing's efforts have failed to curb the drugs and prostitution that spread the disease. Moreover China has an appalling record of suppressing religious freedom, including that of Muslims. In its western region of Xinjiang some have taken up arms.

Yet Muslims from neighbouring Myanmar flock to Yunnan. In cities such as Jinghong and Liuku, they sell Burmese gems in shops decorated with Arabic calligraphy and pictures of Mecca. A jeweller in Jinghong, who has lived here for six years, says that in Myanmar “the Buddhists fight us Muslims and don't let us work. The government is very evil. Here in China you can work in peace.”

No one knows how many Burmese live in Yunnan. Many enter illegally. Official statistics suggest that Muslims make up about 4% of Myanmar's population of around 47m, but that is almost certainly an underestimate. The ruling junta has a history of discrimination against Muslims, particularly the Rohingya ethnic group, more than 250,000 of whom fled from Arakan province into neighbouring Bangladesh in the early 1990s.

Mosques and schools in Myanmar are shut down arbitrarily. Many Muslims find their movements restricted unless they pay hefty bribes; others languish in detention after officially instigated clashes with Buddhists. It does not help that their political sympathies often lie with the democratic opposition, whose leader, Aung San Suu Kyi, remains in detention.

In China, in contrast, the Burmese find that, as long as they make no trouble, their faith is immaterial. Compared with other countries of refuge, such as Bangladesh, China offers relative stability. Even America is not as enticing a prospect. The jeweller frets that, as a Muslim, he would risk jail there. Business in China is booming, too; jewellers can make as much as 30,000 yuan ($3,900) per month.

The local population gives them a mixed reception. The Hui—ethnic-Chinese Muslims many of whom have family in Myanmar—are friendly to their co-religionists. Burmese men here boast of taking Hui mistresses and wives. But Yunnan, like much of China, remains plagued by vast income inequality; the wealthy

jewellers live beside subsistence farmers. Some resent the better-educated, wealthier Burmese immigrants. Undercurrents of racism do exist, as do reports of Burmese trafficking guns and drugs.

If the resentment flares into violence, many Chinese Hui might side with the Burmese. As heroin and AIDS have already shown, Myanmar's internal affairs are not just internal. Despite this, China helps prop up its repellent regime even as it offers some of its victims sanctuary.

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India's presidential election

The chosen one

Jun 28th 2007 | DELHI
From The Economist print edition

Unseemly tussle for a ceremonial post

AFP

Sonia (left) and her choice

FOR evidence that there may, after all, be some virtue in dynastic succession, monarchists need look no further than the muddle India is making of choosing its president. The Indian job is largely titular but, like the British monarchy, carries clout when an election produces a hung parliament and the president chooses whom to invite to form a government.

For that reason, governments try to ensure that a new incumbent is on their side, or at least is not an opponent. The current president is Abdul Kalam, 75, a former top government defence and space scientist. With his eccentric floppy hair style, he has managed to demystify the job and appeal to India's young people. From a poor Muslim background, he was a neat choice in 2002 for the government, then led by the Hindu-nationalist Bharatiya Janata Party (BJP). But the current Congress-led coalition did not want him for another term.

The president is indirectly elected for a five-year term by members of parliament and of state assemblies. It is customary for the ruling party to make its choice, and then to try to achieve a consensus. But Sonia Gandhi, who heads the coalition, as usual failed to give a lead and half a dozen or so names were in the air. One was that of Pranab Mukherjee, the foreign minister, but he was too useful as a politically astute deputy to Manmohan Singh, the prime minister. Shivraj Patil, the home minister, was seen as ineffectual by some coalition partners and blindly loyal to Mrs Gandhi by others. The BJP favoured Bhairon Singh Shekhawat, the vice-president, but the government opposed him.

Instead, Mrs Gandhi eventually lighted on Pratibha Patil, a little-known regional Congress loyalist, who was the governor (a state-level presidential role) of Rajasthan. Aged 72, she had been on no one's list. Pictures of Mrs Gandhi holding her hand when the announcement was made were splashed across the newspapers, with laudatory reports of Mrs Patil's background as a socially conscious lawyer. In her youth, said the ponderous *Hindu*, a daily newspaper, she was “a champion table-tennis player and quite the toast of [her] college, winning a beauty title in 1962”.

Then came the bad news, planted no doubt by the opposition. It has been reported (and not contradicted) that a women's co-operative bank she set up gave favourable loans to her relatives and was shut down by the Reserve Bank of India, and that there were problems with a sugar mill she promoted. At the end of the 1970s she favoured compulsory sterilisation of people with hereditary diseases. In the past few days she has made unwise remarks about a dead guru giving her “divine premonition” of a new job. Such reports will, for a time, harm her prestige; but the job is hers. Mrs Gandhi was photographed holding her hand, and the government has the votes.

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Thailand's political stand-off

Penalty shoot-out

Jun 28th 2007 | BANGKOK
From The Economist print edition

The game is not over yet, despite the goals the junta has scored

Get article background

AFP

Has Thaksin bought the right team?

THAKSIN SHINAWATRA, Thailand's deposed prime minister, has been basking in the limelight this week over his takeover bid for Manchester City, an English football club. But back home the military junta that removed Mr Thaksin nine months ago has begun scoring goals against him. Prosecutors have filed the first corruption charges against Mr Thaksin. The military-installed government is threatening to extradite him from Britain over other allegations of crookery. Most of his fortune has been seized by investigators. His Thai Rak Thai party has been disbanded and he and over 100 cronies have been barred from politics for five years.

Mr Thaksin's supporters and other opponents of the military junta continue to stage rallies in front of Bangkok's Grand Palace. But attendance is falling short of the tens of thousands they expected. The blows to Mr Thaksin's comeback plans have encouraged General Sonthi Boonyaratglin, the junta leader, to resile from earlier promises not to cling to power. In a television interview on June 25th he hinted at plans to enter politics after he retires as army chief in September, not denying a suggestion that a new party might be created for him. No doubt entirely coincidentally, the very next day a group of former allies and foes of Mr Thaksin launched Ruam Jai Thai (Thai Unity), a new party that "would not be unfriendly to the military", as one put it.

Mr Thaksin's chances of a swift return to power have been badly dented by the legal moves against him. But, to continue the footballing metaphor, the final whistle is still some way off and the match may well go into extra time. Assuming Mr Thaksin's takeover of Manchester City is approved by the British authorities, his plan is to hire Sven Goran Eriksson, a former manager of England's national side, giving him a big budget to buy new players and transform the team's lacklustre record of recent years. In football-crazy Thailand, this would keep Mr Thaksin in the news.

In the meantime, he promises to fight the allegations against him. Bringing charges is one thing; making them stick in the Thai courts is quite another. Mr Thaksin should also be able to delay for years any moves to extradite him, and perhaps thwart them altogether. Under British law, extradition is forbidden if the defendant can show (as Mr Thaksin claims) that the charges are politically motivated or his basic rights are otherwise at risk. General Sonthi's recent comment that he could not guarantee Mr Thaksin's safety if he returned did sound like a veiled threat.

A constitution-writing body set up by the junta has, under public pressure, cut the most undemocratic bits of a draft charter that it will soon put to a referendum. But the generals are still doing plenty to make themselves unpopular. Besides contemplating extending their rule by electoral means, they are also planning a law that would give Internal Security Operations Command, an army-run body, drastic powers to seize control of the state in the event of a "security threat".

Besides awarding themselves a huge increase in the official defence budget, military chiefs have installed themselves on the boards of state firms, from which, it is alleged, they are seeking big, secret contributions to army funds. The graft-busting bodies set up by the junta have enthusiastically pursued Mr Thaksin's dubious land deals while finding technicalities to prevent them investigating a questionable land purchase by General Surayud Chulanont, the prime minister.

The danger is that, as happened after Thailand's last coup, in 1991, rising public anger at the generals'

attempts to cling to power may eventually lead to violence. Even if the elections promised for late this year take place and return a civilian government, it may be a weak, unstable coalition. Meanwhile, if all goes well, Mr Thaksin will be sitting comfortably in the directors' box at the City of Manchester Stadium, hoping one day to be welcomed home as a hero, his misdeeds forgotten.

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Australia's aborigines

Hard paternalism

Jun 28th 2007 | SYDNEY
From The Economist print edition

Drastic measures for a troubled people

Get article background

AFP

Enjoy it while you can

VISITING an outback aboriginal settlement can be an unsettling experience for the few city Australians who venture there. Large packs of scrawny dogs wander aimlessly in search of food through rubbish-strewn red desert camps. The report of a recent inquiry in the Northern Territory (NT), where many such camps are located, sheds light on their less visible human misery. After visiting 45 aboriginal settlements over the past ten months, the inquiry found violence and child sexual abuse rife in every one.

The report shocked Australia. Its respected authors, Rex Wild, a prominent barrister, and Pat Anderson, an aboriginal health-worker, blamed alcohol, drug abuse, pornography, unemployment and a breakdown of aboriginal culture and identity for the horrors they uncovered. Ms Anderson said alcohol was “totally destroying” families and communities. “Something needs to be done to curb this river of grog.” But the report's headlines were quickly trumped by the response of John Howard, the prime minister.

On June 21st Mr Howard announced that the federal government was taking control of 60 aboriginal communities in the NT, sending police and soldiers in to patrol them and suspending their rights to grant permits to visitors. He also imposed bans on alcohol and pornography, ordered compulsory health checks on children under 16 and declared that welfare payments would be stopped to parents whose children failed to attend school.

The prime minister described this as a response to a “national emergency”. It is also the most controversial intervention in aboriginal affairs in the 40 years since Australians endorsed a referendum transferring power to legislate for aborigines from states to the federal government. Aborigines comprise about 2% of Australia's population, but 29% of the NT's, which covers a vast area. Many settlements there have evolved since Canberra legislated 31 years ago to give aborigines rights to their traditional land in the NT (a self-governing federal territory). Some remote settlements have imposed their own grog bans, and coped well; others have not.

Few question Mr Howard's sincerity when he says the NT report “distressed” him. But questions are also being asked about other aspects of the timing and motivation of his draconian response to an “emergency” dating back years. Mick Dodson, an aboriginal leader, gave warning four years ago that “Our children are experiencing horrific levels of violence and sexual abuse beyond comprehension.” No federal swoop followed.

After 11 years in power, Mr Howard's conservative coalition government now lags in opinion polls as it faces an election later this year. His tough stand on aborigines recalls the one he took against boat refugees in 2001, helping him win his third election later that year. Mr Howard has seized on the NT exposé to recapture the political initiative at a time when polls suggest voters are starting to doubt his mettle.

His actions have divided urban liberals, the main champions of aborigines' rights to self-determination. They have also split the aboriginal community itself. Yet leaders at Mutitjulu near Uluru (Ayers Rock), where police and the army arrived on June 27th, complained some women were fleeing in fear the authorities would seize their children. Mr Wild accused the government of taking a “gunship” approach and ignoring his report's call to invest instead in better education.

Memories of white paternalism linger in many communities. Mr Howard declared that children's welfare comes before “constitutional niceties”. But there are certainly political risks. Some Australians think aborigines are to blame for their own problems, and will resent more money being spent on them. Many others feel troubled by the plight of indigenous people stemming from more than 200 years of European settlement. Whether a heavy-handed approach can succeed where others have failed may prove one of Mr Howard's biggest tests.

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Laos

Dammed if they do

Jun 28th 2007 | SIPHANDON
From The Economist print edition

Dolphins, catfish and people at risk

Get article background

THINK dams inundating idylls in developing countries were things of the past? Think again. To the dismay of many, the Siphandon ("4,000 Islands") district of southern Laos, home to pretty waterfalls, tranquil waterways and a colony of endangered Irrawaddy dolphins, is the site planned for a 240MW hydro-electric dam. Even parts of the Lao government think it is a step too far.

Laos is one of the poorest countries in Asia. Its government is eager to harness what natural resources it has, notably an abundance of mountains and surging rivers. Seven dams are already working on its bit of the Mekong and 11 more are under preparation, including the massive, and controversial, 1,088MW Nam Theun 2 project. In 2006 the government signed a deal with Mega First of Malaysia to look at constructing a barrage across the Hou Sahong channel of the Mekong, near the Cambodian border. The idea is to sell electricity to Cambodia, Thailand and Vietnam.

The project is backed by most of the government and by Khamtay Siphandon, an 83-year old former guerrilla leader and ex-president who took his name from the district where he was born. But it has incurred the wrath not only of green campaigners but of people within the government's own ranks.

Some officials want the affected wetlands listed under the Ramsar Convention, an international treaty protecting such areas. Experts in fisheries and even the assessment commissioned by Mega First and an Australian partner said the project posed serious threats. If the dam goes ahead it may block a channel that more than 200 species of migratory fish, such as giant catfish, use to bypass waterfalls between Laos and Cambodia. This would disrupt their breeding cycles and might wreck the livelihoods of the riparian population. Last month 34 scientists from around the world signed an open letter stressing the importance of this migration channel. Around 70m people in Laos and beyond depend on Mekong fish.

Mega First wants to build a “fish pass” to deal with migration—a non-starter, say opponents, given the huge number of fish that traverse the area. They hope this is one project where an international outcry, threats to a rare ecosystem and potential loss of local livelihoods may offset the probably limited financial gains from supplying power to Laos's neighbours.

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Iran

Muzzling dissent and moving to a war footing

Jun 28th 2007
From The Economist print edition

Claudio Munoz

In two articles, we look at how an increasingly nervous regime is stifling dissent while putting out ambiguous new signals about its nuclear plans

Get article background

THE government's opponents, real or imaginary—be they secular liberals, trade unionists, campaigners for women's rights, immodestly dressed youths, disgruntled ethnic minorities, even dissenting clergymen—have recently been subjected to a string of arrests, harassment and threats. There are fears that Iran is slipping back into a more repressive mode.

This generally edgy feeling sharpened this week when the government suddenly announced that petrol would be rationed within hours. This caused chaos at pumps, with drivers fighting over the last drops of fuel; some of them chanted anti-government slogans and set cars on fire. A cap on consumption of 100 litres (22 gallons) a month shows that the government is nervous about relying on imported fuel. The unrest suggests that people are getting cross about the economy.

Yet this does not mean that political dissent is bubbling up more widely. The regime's detractors may well feel angrier than in the past but they have little scope for expressing their feelings. The crackdown is probably not because of a real threat from within; it is a way of responding to pressure from outside. The authorities are moving towards a war footing for fear of military strikes, an economic embargo or American plans for a “velvet revolution” leading to a change of regime.

Some officials are using this sense of crisis as a pretext for attacking opponents at home. “The arrests, the intimidation, even the economic policy is about preparing Iran for the biggest outside threat it has faced since the Iran-Iraq war,” says a prominent economist. “These people have military backgrounds and see dissent as a security issue. They're very paranoid.”

Since December, the UN Security Council has passed two resolutions imposing sanctions on Iran because of its persistent failure to be candid about its nuclear programme, while the United States has pressed Western companies to cut ties with the Islamic Republic. It has sent more troops and battleships to the Persian Gulf and has detained Iranians inside Iraq. The American press continues to speculate about American and perhaps Israeli air attacks against Iran's nuclear sites.

Iran has also reacted vehemently to last year's decision by the American administration to give $66m to Iranian opposition groups. Most of the cash is for radio and satellite broadcasters putting across views at odds with those beamed by Iranian state television, but $20m is for unnamed groups inside Iran. Charities, lobbies for democracy, human-rights campaigners and other groups have all been accused of taking the money to subvert or overthrow the government. Many Iranian campaigners advised the Americans against providing the dollars because they predicted such consequences. The overall figure is expected to rise to $75m next year.

Though a spate of arrests has occurred in the past few months, a mood of fear has been building up for more than a year. Many Iranians interpreted last summer's detention of Ramin Jahanbegloo, a mild-mannered academic, as a warning not to attend political or cultural conferences abroad. In September Iran's largest liberal daily, *Sharq*, was closed; it reopened last month but the ban may have made its journalists more cautious than before.

This year in March, campaigners for women's rights were arrested en masse and held for several days for defying a government order not to protest. A teachers' demonstration was also broken up and a variety of other people arrested in the same month. But a worse crime, in the state's eyes, is colluding with Western governments or organising opposition to the authorities. At present, the authorities seem keener to intimidate would-be dissenters rather than imprison hundreds of them. By locking up a few well-known ones, the authorities are serving notice to intellectuals generally to watch their step. A case in point was the arrest in April and May of four prominent and scholarly Iranian-Americans, accused of spying and plotting a “soft revolution”.

It is unclear if the cases against them will be pressed: Iran may try to use them as bargaining chips to win the release of some Iranians taken prisoner by the Americans in Iraq. In any event, the arrests have frightened other academics and analysts. The harassment of guests leaving a British embassy party earlier this month was likewise meant to discourage Iranians from consorting with Western diplomats.

Some people have suggested that the authorities are plotting a new cultural revolution. They have certainly embarked on one of the harshest morality campaigns for several years. But the crackdown on socially loose behaviour, which after two months has begun to slacken, may also have been driven by a desire to placate conservative clergy in Qom, Iran's most religious city, where several of them have criticised President Mahmoud Ahmadinejad for letting standards slip.

In any event, the regime has been going out of its way to display its strength. Police and militiamen have been manning “morality checkpoints” across Tehran, the capital, and have been publicly beating and humiliating alleged gangsters in the rougher parts of the city, who were paraded on television after being beaten up and forced to wear derogatory placards. This grimly reminded liberals of a period in the 1990s when intelligence agents assassinated known criminals as part of a campaign to bolster “social security”—and then started to kill a number of well-known intellectuals and dissidents too.

The supreme leader, Ali Khamenei, who is more powerful than the president, has dubbed 1386 (in the Muslim calendar), which started in March, a “year of national unity and Islamic consolidation”. He has made several speeches denouncing foreign attempts to divide Muslims and Iranians. The presence of more old soldiers in the government's upper ranks has shifted the power balance, which in the past prevented any one faction from winning too much control. Since Mr Ahmadinejad's election as president in 2005, younger conservatives have dominated key positions. Many of them view politics through a military prism. It is they who are keenest on the present crackdown.

Elections for municipal councils and an influential clerical body last December suggested that the moderates, led by a former president, Akbar Hashemi Rafsanjani, were regaining some influence. But recent events, including the crackdown, point the other way. The brief arrest in April of Hossein Mousavian, a former nuclear negotiator and old ally of Mr Rafsanjani, showed how strong the hawks are. Last week a group of angry right-wing radicals and seminarians gathered outside a clerical court in the eastern city of Mashhed to demand the prosecution of a former president and leading reformer, Muhammad Khatami, for having shaken hands with some women during a recent trip to Italy—a bad error under a strict interpretation of Islamic law.

Either the reactionaries are rattled by the prospect of the general election due next year, or they are flaunting their confidence that they are in charge. In Iran's opaque politics, it is hard to say which.

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Iran and nuclear diplomacy

A yes or a no?

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Diplomacy for diplomacy's sake

IF IRAN were to decide to end its high-wire defiance of the UN Security Council and open negotiations for a diplomatic solution to the stand-off over its nuclear work—telling all about its nuclear past and suspending production of potentially bomb-useable uranium and plutonium—it would need to find a ladder to climb down on. Constructing one has been the aim of European diplomats in months of off again, on again talks. So far, to no avail.

Suspension, Iran insists, is out. Instead, as the council has stepped up sanctions, Iran has speeded up the installation of centrifuge machines at its enrichment plant at Natanz and cut back co-operation with the International Atomic Energy Agency, the UN's watchdog. So what to make of a new offer from Iran's nuclear negotiator, Ali Larijani, to talk to the IAEA about answering its inspectors' persistent questions?

Last year, in an effort to avoid being referred to the Security Council for its egregious breaches of nuclear safeguards, Iran offered to clear up all outstanding issues in just three weeks. It never did. Inspectors want answers about undocumented imports of nuclear kit, unexplained traces of plutonium and enriched uranium, suspected military links to what is claimed to be a peaceful nuclear programme, and the possession of documents and the conduct of experiments that make little sense except as part of a weapons programme.

Sceptics note that Mr Larijani's latest offer (talks about ways to provide answers, rather than just giving them) comes as sanctions discussions—on the agenda of George Bush's meeting next week with Russia's Vladimir Putin—are set to resume at the UN. Yet for months Iran has insisted it would not co-operate in the inspectors' quest until its case was returned from the Security Council to the IAEA.

The agency's director-general, Mohamed ElBaradei, professes himself encouraged by the apparent change of heart. In a report to the IAEA's 35-nation board in June, Mr ElBaradei had called Iran's obstruction of the inspectors' work “disconcerting and regrettable”.

In his talks with European diplomats, Mr Larijani has also toyed with the idea of a time-limited suspension of enrichment work—only to be overruled by his bosses in Tehran, says Gary Samore of the New York-based Council on Foreign Relations. It was never clear whether his aim was to get negotiations started without too much loss of face or just to head off sanctions. Offering to dribble more information to inspectors may likewise be a play for time.

This week Mr Larijani praised Mr ElBaradei for an earlier controversial suggestion that Iran might as well be allowed to continue limited enrichment, since it had already mastered many of the skills. Mr Larijani also knows that both Russia and China are unenthusiastic in principle about sanctions. By sounding emollient rather than defiant, he may be hoping they will all help keep the UN off his back.

And if they don't, or won't? Pointing out what Iran needs to do to restore its nuclear reputation and searching for ways to get negotiations going may not be time wasted. Eventually, the diplomats hope, Iran, in an increasingly tight spot, will reach for both as its ladder to climb down on. But no one is holding their breath.

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Israel and Palestine

Awkward pause

Jun 28th 2007 | GAZA AND JERUSALEM
From The Economist print edition

No one knows what will happen next in the divided Palestinian territories

Get article background

THE bougainvilleas outside President Mahmoud Abbas's house in Gaza City are in full pink-and-white bloom. But the Islamists' green ensign, hoisted over government buildings all over Gaza after they wrested control of the strip this month from forces loyal to Mr Abbas's Fatah party, has been replaced once again by the Palestinians' four-coloured national flag.

For now, Gaza is quieter than it has been for months. Hamas gunmen keep a low-key but vigilant guard at street junctions, government buildings and foreign aid agencies' offices. Aid workers report that even the clan feuds that have plagued the strip are being toned down from gun battles to fisticuffs. “People are now aware there are consequences if they do something wrong,” says Ahmed Yusuf, an adviser to Ismail Haniyeh, the Hamas ex-prime minister sacked by Mr Abbas.

Reuters

Olmert and his new best friend Abbas

Having lashed out bitterly at Mr Abbas for firing the Hamas-led coalition government and appointing a new one, Hamas leaders now seem keen to broadcast conciliatory messages. Mr Haniyeh has called for talks with Fatah and would reportedly be willing to let an independent figure lead a new Hamas-Fatah coalition. Mahmoud Zahar, more of a hardliner within Hamas, has called for conciliation too. Some Fatah members have been getting summoned to appear at police stations in Gaza by Hamas's military wing, but Mr Yusuf insists that they are interested only in certain people who have been “working against our interests and with foreign agents”. Indeed, police loyal to Fatah staged a convoy in protest against the new government's orders to them not to work with Hamas.

Israeli officials see in all this signs that Hamas now fears isolation after its takeover of Gaza. Mr Abbas's interim government in the West Bank is running the ministries and paying the staff in Gaza too. However, the strip's main border crossings, the Karni terminal for commercial trade with Israel and the one at Rafah, the sole exit to Egypt, remain closed because neither Israel nor European monitors at Rafah will deal with the Hamas men who took them over from forces of the Palestinian Authority (PA). Discussions over finding non-Hamas people to run the Palestinian side of Karni have got nowhere. Humanitarian aid is getting through at two smaller crossings, but John Ging, head of the UN's refugee agency in Gaza, says that unless trade resumes too, Gazans' “lives will be sustained while their economic plight will deteriorate and the last remaining businesses will die off quickly.”

Israel seems in no hurry to prevent that; nor does Mr Abbas, nor their local allies, the leaders of Egypt and Jordan. At a summit of the four of them in the Egyptian resort of Sharm el-Sheikh, Ehud Olmert, Israel's prime minister, promised to release some $560m in frozen tax revenues to the PA, free 250 Fatah prisoners from Israeli jails, ease restrictions on the movement of Palestinians in the West Bank and enhance Israeli trade with them. For Gaza, he promised only to let humanitarian supplies through, but claimed that Israel “has no interest in punishing this population”.

Paradoxically, though, Israel's interest in restoring trade may be greater than Mr Abbas's. This autumn, Israel begins the one year in seven when Jewish farmers are meant to let their land lie fallow; observant Jews will not eat food from Jewish farmers who break the ban. By tradition, crops from Gaza make up the shortfall.

Gaza has already suffered disproportionately under the world's economic boycott of the Hamas-led PA—

which, as Israeli and Western leaders never tired of saying, was not meant to “punish” the Palestinians either. Their economy shrank last year by 8-10%. And while total Palestinian unemployment rose last year, that was the product of a small drop in unemployment in the West Bank and a larger rise in Gaza, to 35%. Mr Olmert and Mr Abbas both hope to squeeze Hamas without punishing Gazans too much. But if the economic straitjacket stays tight, says a senior European diplomat, “in the long term I think the situation will be disastrous.”

Squeezing Hamas

The pressure on Hamas could become fierce, especially if Egypt at last plugs, as Israel has demanded for months, the smuggling tunnels under its border with Gaza, slowing the flow not just of weapons but of money for Hamas's militants. But it is early days. Mr Abbas will shortly face the problem of how to keep his government in place without ratification by the Hamas-dominated parliament. And Hosni Mubarak, Egypt's president, surprised his guests at Sharm el-Sheikh by seeming to back away from the tough anti-Hamas position he had taken a week earlier and calling, as Hamas is doing, for Hamas-Fatah talks.

But not everyone in Gaza wants calm. Unknown militants attacked the Kerem Shalom crossing this week, forcing Israel to close it for a couple of days. Did Hamas allow them or was it simply unable to stop them? Mr Yusuf says there is now a “gentleman's agreement” between Gaza's assorted armed factions to attack Israel only in response to Israeli actions, such as its killing of several militants in Gaza this week. But some Fatah loyalists could also have an interest in destabilising things. Have pity, then, on Tony Blair, who will have to juggle all these conflicting interests as a new peace envoy (see article).

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The Middle East quartet's new envoy

Can Tony Blair help make peace?

Jun 28th 2007
From The Economist print edition

A poisoned chalice for Britain's departed prime minister

Get article background

ON THE face of it, he is an odd choice. Tony Blair's reign as Britain's leader has been blighted—indeed, ended—by the unpopularity he incurred at home and abroad, especially in the Muslim world, for his part in creating the turmoil in Iraq after helping to overthrow Saddam Hussein. Why, as he leaves national office, would he jump straight back into the Middle East cauldron, where his reputation has been so badly burnt? And why would the peace-seeking "quartet" of countries and international clubs—the United States, Russia, the UN and the European Union—want him as their roving broker, just when hopes for peace between Arabs and Jews look even slimmer than usual?

The first answer is that Mr Blair has great confidence in his powers of persuasion and has been saying publicly for nearly a year that he wants to help the cause of peace in the Middle East even after leaving office. Second, he must dearly wish to shake off the burden of failure in Iraq and leave a legacy of peace rather than misery, albeit in another part of the region. He looks, of course, to his success in making peace in Northern Ireland during his ten years in office, using his vaunted qualities of tenacity, charm and tactical guile.

Deploying them to bring Israelis and the now bitterly divided Palestinians together may be another matter. If, however, he seeks to bring Hamas into negotiations from which they have so far been excluded because of their refusal to recognise Israel, he may think back on all the obfuscations and fudges needed to bring the Irish Republican Army and its political arm, Sinn Fein, into a peace process.

In any event, his initial mandate looks a lot more modest. The quartet's last envoy, James Wolfensohn, an American former head of the World Bank, was appointed in the summer of 2005 specifically to co-ordinate Israel's imminent withdrawal from the Gaza Strip and to focus on economic ways to help the Palestinians after the Israeli exit. But he left his post a year later, citing Israel's refusal—as he saw it—to engage seriously in a wider peace process. Mr Blair's focus, at any rate to begin with, will be on building Palestinian institutions and seeking to mend the Palestinian economy—but not yet to start thinking about Israeli-Palestinian negotiations or luring Hamas into talks. But he may be loth to accept so technocratic a role for long.

More recently, the outgoing UN envoy within the quartet, Alvaro de Soto, has written bitterly about the group's failure to make headway. He blames the Americans for doing Israel's bidding and the UN and the EU for supinely letting themselves be bounced into accepting whatever the Americans argued for, especially in their determination, as he saw it, not to draw Hamas into negotiation and not to open the door to Syrian participation, two conundrums Mr Blair will have to ponder.

His appointment has aroused suspicion among many Europeans as well as Arabs, both lots deeming him too close to America and George Bush, and therefore likely to favour Israel; they particularly resented his refusal to condemn Israel for its war in Lebanon last year. A Hamas spokesman was quick to denounce his appointment, while Javier Solana, the EU's foreign affairs chief, was said to be sour about it.

However wary, most Arabs know that the quartet can be effective only if it has American backing—and that Mr Blair has a better chance than most of bringing the weight of the superpower to bear.

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Lesotho

Poor little brother

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Why Lesotho is still unstable

MASERU, capital of the tiny mountain kingdom of Lesotho, is hardly a nightlife hotspot. But it reached a new depth of deadness two weeks ago when a curfew forced people to stay home at night. This was the government's response to attacks on the homes of several ministers and of the main opposition leader. The curfew has now been lifted, but the army announced it had foiled a coup attempt. Roadblocks are still frequent.

Trouble had brewed since a general election in February. The opposition contested the results in several constituencies and rowed over the allocation of some seats by a proportional system.

Political instability has marred Lesotho since independence in 1966. Election results have been almost always contested, leading to a rash of coups and mutinies. In 1998 South Africa and Botswana sent troops to restore order. The electoral system was changed and the 2002 poll was quieter, but instability has returned. Mpho Malie, secretary-general of the ruling Lesotho Congress for Democracy, says progress has been made in keeping the army out of politics but rogue soldiers and policemen still make trouble.

Surrounded by South Africa, Lesotho has barely 2m people but too few jobs. Most of its land is mountain. But for a quirk of history that made Basutoland (Lesotho's forerunner) a British protectorate, it would probably have been a South African province. Textiles are the only notable industry. Some 50,000 of Lesotho's men work in South African mines. Almost one in four adults has HIV/AIDS. This year the rains failed: a fifth of the people, says the UN, may need food handouts next year.

Many young Basotho, caught between joblessness and emigration, want change. The All Basotho Convention, created a few months before this year's election by Tom Thabane, a cabinet veteran who defected from the ruling party, has capitalised on this. At a wind-swept rally last week in the mountain village of Moitsupeli, horsemen wrapped in traditional blankets rubbed shoulders with young professionals from Maseru. Mr Thabane fired up the crowd with jokes, biblical quotations and promises of change.

In fact, the economy has begun to grow a bit faster and the budget is in the black, thanks to receipts from a customs union with South Africa, Botswana, Namibia and Swaziland. The government wants to diversify the economy. Besides making T-shirts for sale in America, Lesotho has diamonds and water. Foreign investment in diamond exploration and mines is up, but the terrain is tricky and infrastructure poor. Billions of dollars have been invested in the Lesotho Highlands Water Project, which sends drinking

water to South Africa and electricity to the region, bringing in much-needed royalties.

In the end, the kingdom will go on depending on its big neighbour. It imports most of what it needs from South Africa, pegs its currency to the rand and gets life-saving remittances from the many Basotho working there. Luckily, big brother is keen to keep the little one on its feet—and his soldiers in the barracks.

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Iraq's Kurds

Justice, up to a point

Jun 28th 2007 | HALABJA
From The Economist print edition

The Kurds say they still want more of it

Get article background

THIS week's death sentence on Ali Hassan al-Majid, architect of the Anfal (Spoils) campaign in 1987-1988 against Iraq's Kurds, of whom up to 180,000 may have been killed, does not mark the end of the affair. After months of evidence of gassing, deportations and mass graves, Iraq's special tribunal found "Chemical Ali", as Saddam Hussein's cousin is more widely known, guilty of various heinous crimes, including, most significantly for the Kurds, genocide. But Nechirvan Barzani, prime minister of Iraq's Kurdistan region, said that the tribunal's definition of the Anfal as a genocide was just a first step in a new campaign to have that military operation recognised as a genocide by the rest of the Arab world as well as by international bodies such as the UN.

The Kurds have long sought such recognition for the Anfal as well as separate acknowledgement for the crime of the gas attack on the town of Halabja, where 5,000-odd people were killed in 1988. In the mid-1990s a New York-based lobby, Human Rights Watch (HRW), which documented the Anfal crimes, including the razing of 3,000-plus Kurdish villages, tried to bring the issue before the UN Security Council. But too few big countries backed the move.

This week's decision by the Iraqi court is unlikely to give the Kurds the momentum they need: many outsiders question the independence and fairness of the special tribunal in Baghdad. And it is unclear how much support Iraq's Kurds would get from their Arab compatriots in a campaign to win recognition of those mass crimes. Many of Iraq's Sunni Arabs say privately that the Kurds deserved what they got because their fighters sided with Iran in the war with Iraq in the 1980s—an argument used by Mr Majid in the trial just ended.

In the early 1990s Kanan Makiya, an Iraqi Shia Arab, in a book called "Cruelty and Silence", lambasted Arab politicians and intellectuals in the region for their silence about the regime's brutalities. This week's reaction, muttered the Kurds, was not so different. Pan-Arab satellite television channels covered the trial and its verdict widely. But its commentators and those in Arab newspapers dwelt little on the mass murders for which Mr Majid was condemned.

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Germany

Merkel's magic

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EPA

Can the chancellor's formula work as well in Germany as it seems to abroad?

Get article background

ANGELA MERKEL is proving a champion of the art of the possible. As she emerged tired but triumphant from a marathon summit in Brussels that agreed to a new European Union treaty, the German chancellor had again shown her skill in finding consensus where none seemed likely. She pulled off a similar trick at Heiligendamm three weeks ago, when she persuaded world leaders at the G8 summit, including America's George Bush, to make new pledges to combat climate change.

Those close to her attribute her diplomatic successes to her emotional intelligence: an ability to put herself in the shoes of every protagonist in a complex multilateral chess game. And she keeps her cool. Even in the face of gratuitous anti-German comments from Jaroslaw Kaczynski, the Polish prime minister, she did not bite back. “She has fantastic timing,” says Jürgen Falter, a political-science professor at Mainz University. She was even prepared to be upstaged in Brussels by Nicolas Sarkozy, the energetic French president (see article), if it got the job done.

Her other talent, as president of both the G8 for this year and the European Union until July 1st, has been to create the right atmosphere for co-operation. For example, she chose Meseberg, a baroque castle an hour outside Berlin, as a setting for informal talks before both summits. Even Vaclav Klaus, the touchy Eurosceptic Czech president, gave ground in a chat chaperoned by Roman Herzog, a former German president, to Ms Merkel's mix of charm and persistence.

Ms Merkel and Mr Sarkozy represent a new generation of leaders of the big European powers. This week they were joined by Britain's Gordon Brown. The scratchiness, frigidity and occasional pomposity of their predecessors, Gerhard Schröder, Jacques Chirac and Tony Blair, who between them have dominated European debate for around a decade, are a thing of the past, as is the biggest bone of contention: the decision to go to war in Iraq in March 2003. Although the new triumvirate is starting on good terms, it remains to be seen how well they get along when it comes to bigger European arguments—though one certainty is that Europe's relations with America can only improve.

On the home front

The question being asked in Germany is whether Ms Merkel's new diplomatic magic can help to win her

another term of office at home. There is no doubting her personal popularity. The latest opinion polls show that 55% of voters would like her to remain chancellor if an election were held tomorrow. But her position depends on the survival of the grand coalition between two big parties that usually oppose each other: her own Christian Democrats (CDU) and the Social Democrats (SPD).

Most pundits expect the coalition to last its full term, until September 2009. But the strain between the odd bedfellows is showing. Kurt Beck, the SPD leader, recently accused the CDU of being “neo-liberal”, a term of abuse that even German conservatives cannot stomach: all parties except the centrist Free Democrats (FDP) profess full support for a social-market economy. Franz Müntefering, a former SPD leader who is now vice-chancellor and is normally fiercely loyal to the grand coalition, broke ranks on June 19th. After a scrappy compromise was reached to avoid introducing a nationwide minimum wage, he openly accused Ms Merkel of party politicking. The first shots have been fired in what could turn into a two-year election campaign that may paralyse the government less than halfway through its term.

There are signs of panic on both sides of the grand coalition. The CDU (with its Bavarian sister party, the Christian Social Union) scores an average of 37% in today's polls. It would need over 40% to form a government with its preferred partner, the FDP. The SPD, whose support has slid to some 26%, has two big problems: doubts about Mr Beck as its leader and the full emergence of the Left Party as a rival. Both coalition partners feel the need to create some clear blue water between them by redefining what they stand for.

In response, theCDU has blurred its image a bit by espousing green and social causes, such as the environment and the family, and throwing more money than it had planned at social policies such as health, welfare and child care. For its part the SPD needs to escape association with its two heavy-hitters in the cabinet, Peer Steinbrück, the finance minister, and Frank-Walter Steinmeier, the foreign minister. These men may be doing a good job for their country but they are certainly not helping their party. Mr Beck, a popular premier in Rhineland-Palatinate, has been unable to extend his appeal farther north. There are no promising contenders for his job, save perhaps Mr Steinmeier. But this former head of Gerhard Schröder's private office is not an elected politician and has no grassroots support.

The most charismatic man on the left is Oskar Lafontaine, who once led the SPD but now co-heads the Left Party. This party comes from a merger of WASG, a labour union, with the predominantly eastern German Democratic Socialists, most of whom are ex-communists. It has, says Oskar Niedermayer, a political-science professor at Berlin's Free University, caused a one-time shift in Germany's political balance of power. Given the continuing strength of the Greens, any future government (other than another grand coalition) will probably have to embrace three parties, not two.

Ms Merkel's party must contemplate a deal not only with the FDP but also with the Greens, to make a “Jamaica” (after that island's flag) coalition. The weakened SPD may need a coalition that includes not just the Greens, its usual partner, but also the FDP or the Left Party. The SPD and the Left Party are unlikely to do business so long as Mr Lafontaine is around. He stormed out of Mr Schröder's cabinet and the SPD in 1999; the party's old guard refuses to deal with him. Yet the siren-like Mr Lafontaine tried to woo the SPD in an interview this week, saying that, if certain conditions were met, such as the minimum wage and pulling German troops out of Afghanistan, “Beck can be chancellor tomorrow.”

As panic rises, the SPD rank and file may come to see this as an appealing way out of their party's straitjacket. But for the time being it is more likely that the grand coalition will stick together. That gives Ms Merkel two years to come up trumps on the domestic as well as the international front. She may have to start wooing the Greens, as well as building more grassroots support in her own party. The strongest CDU figures are the state premiers, notably Roland Koch in Hesse and Christian Wulff in Lower Saxony. But their support would be two-edged, since each has ambitions to be chancellor. Ms Merkel's most important ally may be Ursula von der Leyen, the family minister, who has successfully encroached on SPD territory.

The usual mistake of Ms Merkel's opponents has been to underestimate her. But the cards stacked against her at home may mean that practising the art of the possible is no longer enough for success.

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Eastern Germany

We ain't got dames

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From The Economist print edition

Young layabouts suffer a drought

A NEW disease is abroad in eastern Germany: *Frauenmangel*, lack of women. In some towns there are only 75 young women for every 100 young men. In one or two there are as few as 40. The effects are worrying, not only because populations may shrink but also because of the existence of a growing underclass of young men who are partnerless, underqualified and jobless.

A study by the Berlin Institute for Population and Development has looked at Herzberg and Ebersbach, two small towns in eastern Germany. “Even the mayor of Ebersbach hadn't realised this is going on,” says Reiner Klingholz, the institute's director. It is a vicious spiral. Girls are more studious than boys, so they get better qualified and migrate west to find both partners and jobs. The boys lack role models at home, where fathers are often unemployed, and at school, where teachers are mostly female. Young men now account for 65% of German high-school dropouts.

The few women who stay prefer single parenthood to hitching themselves to useless partners—benefits for single mothers are generous. It is women who are now masters of their destinies. The study, which combines reportage with figures, tells of frustrated gangs of youths drinking outside supermarkets and sleeping on their loading ramps.

What can be done? Eastern Germany is now a laboratory for the rest of Europe, says Mr Klingholz, since other places are starting to see the same phenomenon. Better education is the key. “We have to take the risk that the young men will then emigrate too,” he says. At least they will find jobs more easily. The federal government wants to identify two “model regions” where it can spend money on urban renewal and health, education and sports facilities. This smacks of too little too late—it is 17 years since unification. But it is better than the “watering-can” of sprinkling cash everywhere in hopes that something grows.

The despair shows itself in many ways. The death rate among young men in Mecklenburg-West Pomerania, in eastern Germany, is twice as high as in the west's North-Rhine Westphalia, mainly because of road accidents (despite there being fewer cars). And the most fertile ground for the extreme-right NPD is now in places with a shortage of women, not high unemployment.

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France's hyperactive president

The Sarko show

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A new star takes the European stage

HOLLYWOOD calls it star quality. In politics, the word is charisma. Nobody can define it; everybody wants it; and France's President Nicolas Sarkozy seems to have it. That was certainly the impression created at the European Union summit in Brussels. As Britain's Tony Blair briefed jaded reporters in a room dotted with empty chairs, Mr Sarkozy wowed a jam-packed press room next door. One diplomat talked admiringly of his “fizzing political energy”. Even the leftish daily *Libération* declared the summit “an unquestionable success” for Mr Sarkozy, and published a poll showing that 63% of French voters approve of him.

Nearly two months after his election, outsiders are getting the measure of the “hyper-president”. For ten years, Mr Blair has been the European leader who fascinated his peers the most. Now Mr Sarkozy could take on that role. His showmanship may sometimes grate, but even his detractors recognise his energy and his deal-making skills. “Frankly,” said Jack Lang, a Socialist Party grandee, of the summit, “we couldn't have done it better.”

The main trophy Mr Sarkozy brought home from Brussels was the new simplified treaty that, he likes to recall, he single-handedly dreamt up as a presidential candidate. But there was more. “We have obtained a major reorientation of the union's objectives,” he said of the removal of a clause enshrining “free and undistorted competition” as an EU objective. To the consternation of market liberals, he said this meant “the end of competition as an ideology and dogma” in Europe.

What is the hitherto reformist Mr Sarkozy's game? Partly, it is just domestic politics. Although he has been handed a robust mandate, Mr Sarkozy is still mindful of the 55% of French voters who rejected the draft EU constitution in a referendum two years ago. Among them was around half the Socialist Party. At the time, the No campaign denounced the phrase on undistorted competition as evidence of a liberal Anglo-Saxon plot. When parliament ratifies the new treaty, probably next year, Mr Sarkozy hopes to deploy the removal of this clause to disarm rejectionists.

A second answer, however, has more to do with conviction than tactics. Mr Sarkozy has long advocated an unorthodox blend of free-market economics with unapologetic industrial interventionism. On fiscal policy and labour-market reform, he is genuinely liberal. But as finance minister in 2004 he irked the Germans by helping a French drug firm to take over a Franco-German rival, as well as thwarting an effort by another German company, Siemens, to buy bits of Alstom, a French engineering group. Mr Sarkozy persuaded the European Commission to let him use taxpayers' money to rescue Alstom—which in the end paid off handsomely for the state—but was exasperated by the bruising battle it involved. He thus showed not only his belief in national champions, but also his visible irritation with the idea that such champions can be blocked by Brussels.

In Mr Sarkozy's case, this belief is not merely a classic Colbertist reflex. He did not attend the elite Ecole Nationale d'Administration, so is not programmed to believe in *dirigisme*. Rather, he mixes Gaullist faith in the state with a tinge of industrial romanticism. During his election, his preferred campaign stop was the factory floor, where he liked to be surrounded by workers in blue overalls and hard hats, symbols of the industrious values of muscular hard work and early rising. Everywhere he repeated his rallying cry: “If the factories go, there will be nothing left.”

Mr Sarkozy is thus promising to be a vigorous defender of French industry. This could provoke awkward clashes. In mid-July, he faces delicate negotiations over the future of the aviation group EADS at a Franco-German meeting in Toulouse. On non-industrial matters, and to British indignation, he is also serious about opposing Turkish membership of the EU: this week France blocked the opening of one of three new chapters in Turkey's negotiations. In short, nobody should doubt Mr Sarkozy's determination to get his way. Star quality may dazzle, but even box-office sensations can be hard to deal with.

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Sweden and Finland

New boots for NATO?

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But it may have to wait for a new American president

FEW new members would be more welcome in NATO than Sweden and Finland. Their military hardware is compatible, and in Sweden's case ultra-modern. They are in the right place. And the timing would be most welcome: a clear rebuff to Russia's assertive, divide-and-rule, approach to Europe.

Both countries remained neutral during the cold war. But Finns and Swedes were outraged by the Russian-stoked riots in Estonia in April, and by the blockade of Estonia's embassy in Moscow (the Swedish ambassador's car was also attacked). Swedes fret about a planned Russian-German gas pipeline on the Baltic seabed, which may be bad for the environment and will be defended, says Russia, by an enlarged Baltic Sea fleet. Since the cold war, both Finland and Sweden have slimmed down their defences.

Sweden's right-of-centre government is privately sympathetic to closer links with NATO. Its foreign minister, Carl Bildt, has banned the word “neutral”—once the central dogma of Swedish foreign policy. Sweden has begun closer co-operation on airspace surveillance and intelligence with Norway, which is in NATO. In the past, foreign military ties were discreet and centred on Finland. Sweden has also helped the Baltic states, NATO members since 2004, with know-how and equipment. Mr Bildt has stepped up his criticism of Russia's drift away from democracy, and its behaviour in eastern Europe.

Finland's armed forces are smaller, worse-equipped and over-stretched; its border with Russia is long and will be more exposed when it gives up landmines, a move reluctantly planned for 2016. Mines are “Finland's nukes”, says Tomas Ries, the Finnish-born head of a Stockholm think-tank. Yet Finnish political leaders have been quiet. The president, Tarja Halonen, is soft on Russia and chilly towards NATO (she dislikes George Bush). She outraged patriotic Finns by describing Estonia (a close ethnic cousin) and Russia as friends of equal importance. The government is privately more hawkish, but does not want to confront Ms Halonen. Still, the European Union's divided stance on Russia, says Risto Penttila, who runs a lobby group, has put NATO membership “top of the security-policy agenda”.

Many Finns are reluctant to join NATO. Four chilly decades and a lost war, they argue, show that hard-headed engagement with Russia, not foreign alliances, guarantees safety. “The Swedes are hysterical,” says a Helsinki-based Russia-watcher. “We were not so happy about Russia in the 1990s, and we are not so worried now.” The Swedes retort that they are prudent, not worried. And they are far from certain to join NATO. Russia may brag about rearmament, but no real military threat is in sight. If the proposed pipeline followed a different route, Swedish concerns would abate. Sweden would probably join the alliance only if Russia turns even nastier—or if Finland joins first.

A more sympathetic American president could just make that happen. Even the NATO-phobic Ms Halonen might soften if a President Hillary Clinton asked her nicely. And polls suggest that, if the political leadership recommended joining NATO, the public would support it.

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Bosnia's future

The Balkan patient

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A new international governor takes over a still divided country

LORD ASHDOWN once hoped he would be the last international governor of Bosnia. But it was not to be. In January 2006 his successor, Christian Schwarz-Schilling, promised that he would be the last. Yet on July 1st a Slovak, Miroslav Lajcak, will become the latest person to take up the post. And he is too canny to say if he expects to be the last.

Twelve years on from its devastating war of 1992-95, it is hard to read Bosnia. If you believed its statistics—and some of its politicians—it should have died long ago. Yet as Srecko Latal of the World Bank likes to joke, "the operations continually fail, but miraculously the patient is still alive." Now Bosnians are waiting to see what sort of ruler Mr Lajcak will be. He is a former political director of the Slovak foreign ministry, an ex-ambassador to Belgrade and the man who, on behalf of the European Union, presided over the independence referendum in Montenegro in 2006.

Lord Ashdown was a highly interventionist governor (see article). Mr Schwarz-Schilling came to office declaring that it was time for Bosnians to take responsibility for running their own country. Mr Lajcak insists that he will have "no hesitation" in using his power if necessary, but adds that he does not intend to be "a Paddy Ashdown clone". Yet the truth is that over the past 18 months political reform in Bosnia has stalled, mainly because last October's election produced victory for two politicians with diametrically opposed views of the country's future.

Bosnia is divided into two entities: the Republika Srpska (RS), dominated by Serbs, and a federation of Bosniaks (Bosnian Muslims) and Croats (plus autonomous Brcko, see box). Milorad Dodik, the RS leader, wants to preserve the status his republic gained in the 1995 Dayton Accords that ended the war. He occasionally jangles nerves by saying that, if Kosovo wins its independence against the will of Serbia, his republic should have the same right to secede from Bosnia. Ranged against him, Haris Silajdzic, the main Bosniak leader, wants to abolish the separate entities altogether, a move that Serbs see as aimed at entrenching Bosniak domination of the entire country.

By the end of 2006 Bosnia and the EU had negotiated a "stabilisation and association agreement", the usual first step on the road to full membership. But it has since gathered dust, as several political conditions have not been fulfilled. The biggest obstacle is police reform. Bosnia has 15 police forces for its 3.9m people. Last March "we came so close to an agreement," says one insider. But close is not good enough. In May Mr Dodik and Mr Silajdzic were even summoned to Washington, DC, in a vain bid to break the deadlock on the police and on constitutional reform.

Mr Dodik is in upbeat mood. Various privatisations have left him flush with cash. Meanwhile, Mr Silajdzic has found another issue to exploit: Srebrenica. In February the International Court of Justice in The Hague ruled that Serbia was not guilty of genocide in Bosnia during the war, but it also declared that genocide had taken place in Srebrenica in 1995, when Bosnian Serb forces killed as many as 7,000 Bosniak men and boys. Bosniaks promptly began clamouring for Srebrenica to be taken out of the RS; some from the town set up tents near Sarajevo to claim they were not safe. Mr Dodik, ever the politician, responded by encouraging Bosnian Croats to demand an entity of their own. Mr Lajcak says mildly that "we need to reverse current political trends in the country."

Osman Topcagic, Bosnia's top official dealing with the EU, argues that, in pessimistic times, everyone should cheer up by looking at the good news. The introduction of VAT has brought discipline to the economy and cash to the treasury. Real GDP growth is running at 6% a year. Mittal Steel is a big investor, as are companies from Serbia, the Czech Republic and even Lithuania. Not for the first time, businessmen are pointing a way forward more constructively than the politicians are.

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Brcko

The hinge in the bracket

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Bosnia's only true multi-ethnic place sets an example for the country

DURING the Bosnian war Brcko was one of the most dangerous places in the country. Taken early by Serb forces, it was the corridor that linked two pieces of Serb-held territory. Because it was only two miles wide, by war's end it was largely in ruins. Yet today Brcko is one of the best-off places in Bosnia.

The future of Brcko almost derailed the talks that ended the war. Its fate was eventually left to arbitration. In 2000 the Serb-held city and its surrounding region, held by Bosniaks and Croats, were reunified into a single autonomous district that belongs to neither of Bosnia's two entities, but comes under its own foreign “supervisor”.

Today Brcko is the only truly multi-ethnic city in Bosnia. Serbs, Bosniaks and Croats work together. Unlike those elsewhere in the country, their children go to the same schools. Shrewd economic policies have helped business. The once ramshackle Arizona market, the first place where Serbs, Croats and Bosniaks came to trade after the war, has been transformed into a modern shopping centre and business park. In 2003 people in Brcko earned twice the average pay of people in Republika Srpska, and a quarter more than the average in the Bosniak-Croat federation. Those differentials have since eroded, not because Brcko is doing less well, but because the rest of Bosnia is catching up.

Given the example its people set by working together, could Brcko be a model for the rest of Bosnia? Mirsad Djapo, the mayor, suggests that what Brcko represents is what the future was meant to be like. Yet Enes Pasalic, whose job at the town hall is to deal with complaints from citizens, says gloomily that “this is simulated multi-ethnicity. People have good jobs and high salaries and that is why we behave like good boys; but we are not good boys.” More enthusiastic is Asim Mujkic, a political scientist, who says his home town is “a stake through the heart of nationalism. If you pulled out the stake, the vampire would revive.” It remains to be seen if the rest of Bosnia will learn that lesson.

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Charlemagne

Treaty blues

Jun 28th 2007
From The Economist print edition

Peter Schrank

Why nobody was happy with the summit deal on a new European Union treaty

Get article background

EVERYBODY always claims victory after European Union summits. Often, this is a transparent fib. But this time, pretty much all those who attended the summit in Brussels walked away with what they wanted (or at least what they said they wanted). That should have made them happy, but didn't. Instead the meeting, intended to draft a replacement for the ill-fated EU constitution, was a strikingly bad-tempered affair. (“Deeply disagreeable”, shuddered one veteran diplomat.)

There are several explanations for this sourness. But the most interesting may be that, although each of three competing camps came away from the summit declaring that they had won, their victories exposed how differently the 27 EU members now see their relationship with Europe.

The first and biggest camp took in the 22 countries that arrived hoping to resurrect the constitution two years after it was stopped by No votes in France and the Netherlands. In broad terms, they succeeded. They had to chop the defunct constitution up and rename its most contentious elements, like a planned “foreign minister”. But in the relieved words of the Irish prime minister, Bertie Ahern, “90% of it is still there.”

The second camp had a single country: Poland. The twin Kaczynski brothers who are Polish president and prime minister fought hard (at one point even arguing that Poland should be treated as a bigger country, because so many Poles died in the second world war). They made few friends, but won one huge concession. The Germans, hosting the summit as holder of the EU's rotating presidency, agreed to preserve for another decade the existing voting rules, which favour Poland and underweight Germany. This gift secured the German chancellor, Angela Merkel, the successful outcome that she wanted. But it left German officials “as miserable as hell”, says one witness.

Conventional wisdom in Brussels holds that Poland will “pay” for its behaviour in a future budget round. That is implausible: the EU is incapable of being vengeful with such precision. More perilous for Poland is the risk of being deemed unserious. Pushing hard for national interests is accepted practice in Brussels. But countries that repeatedly flout the rules, issue empty threats or take Europe for granted end up losing influence: ask Italy, Greece or Cyprus. Tellingly, EU leaders coldly swatted aside a Polish request for laws on “public morality” to be exempted from the charter of fundamental rights. Given the Poles' record of populist social conservatism, it was feared that an exemption would lead to “gays being tarred and

feathered” on the streets of Warsaw, says one diplomat, exaggerating only slightly.

The third camp, comprising naysayers to the constitution, needed visible changes to the text, either because their voters had rejected it (the Dutch and French) or because they probably would have done if asked (the British and Czechs). France's president, Nicolas Sarkozy, became a sort of co-host of the summit, working with Ms Merkel to win others round to his vision of a boiled-down, simplified treaty. But Mr Sarkozy exacted a price for his help. Whereas Ms Merkel toiled away in the shadows, Mr Sarkozy invited press photographers to see him meet a string of leaders, then went for a jog wearing mirror-finish sunglasses and a black T-shirt with the badge of France's toughest police commando unit. Flexing his muscles, Mr Sarkozy persuaded Ms Merkel to drop a phrase about “free and undistorted competition” from a list of the EU's core objectives. Officials explained that this was a political move with no legal consequences, but the signal it sent is still worrying (see article).

Britain claimed victory on all four “red lines” brought to the summit by Tony Blair, in almost his last act as prime minister. These included the right to stand aloof from European police and judicial co-operation, and a (perhaps not watertight) opt-out from any risk that the charter of fundamental rights might threaten British labour laws. Critics at home accused Mr Blair of choosing only winnable battles that were easy for voters to understand but making no effort to fight the loss of scores of national vetoes (one tabloid accused him of “abject surrender”).

The Eurosceptic tide

To attack Mr Blair is to miss the target, however. Those in Britain who hate the new treaty do not really have a problem with the ex-prime minister, but rather with the rest of Europe. For sweeping curbs on national vetoes in the name of a more efficient EU were backed by 26 of the 27 countries.

Indeed, most other governments thought Mr Blair had secured an “outrageous” deal (to use one of the more printable terms), given that he signed up to the full constitution only three years ago. There was special bafflement that Mr Blair insisted that he could have lived with the constitution, even when he was acting as if to recover from some dreadful mistake. The explanation is that other countries were focusing on the wrong mistake. Mr Blair does not really regret signing the constitution. But he is working to recover from the tactical blunder of offering a referendum on it.

Mr Blair got away with his demands only because other leaders can easily guess the result of any British referendum. For similar reasons, each of the naysayers was rewarded with small changes in the text, leaving it an incomprehensible mess of footnotes and protocols. This caused mounting fury among those who liked the constitution (Belgium's soon-to-depart prime minister threw the loudest tantrum, shouting at the Dutch that they were “hollowing out” the European project).

Such peevishness was irrational, in one sense: Belgium wanted the constitution and got a text pretty much like it, albeit spattered in footnotes. But the same footnotes are evidence of Europe's divisions. For anyone whose dream is still some ideal of European unity, the mere fact that each competing camp won at this summit was, of itself, a defeat.

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British politics

Now that he's gone

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From The Economist print edition

Rex

Gordon Brown becomes prime minister just as David Cameron, the first electable Conservative candidate in a decade, is on the back foot. That luck won't last

David Cameron

NOTHING in Tony Blair's decade as prime minister so became him as the leaving of it. His last session at the despatch box on June 27th reminded the House of Commons and the country just what they have loved and hated about him for so long. On poignant display were the self-deprecating humour, the deliberate spontaneity, the appeal to noble sentiments, the refusal to find serious fault with his own performance. This was a leader who inspired, moved and disappointed in spades. The normally partisan Commons rose as one and applauded him as he left the chamber, damp-eyed.

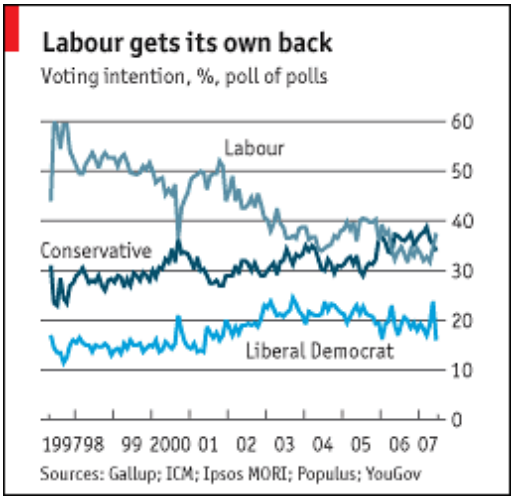
For more than a decade the relationship between Mr Blair and his ally and rival Gordon Brown, the chancellor of the exchequer, has shaped—some would say distorted—British politics. Since well before Mr Blair swept into Downing Street in 1997 with the biggest majority for over 60 years, there has been talk of a secret agreement to cede power in time to Mr Brown. For the past year and a half of this interminable handover, the strains of that relationship have deflected direct confrontation between the chancellor who helped create the “Blair legacy” and David Cameron, the newish Conservative leader who claims to be its true inheritor.

Now, as Mr Blair leaves the Commons to bestride a bigger stage as Middle East peace envoy, the real contenders are squaring off at last. “Tony's going, and the phoney war will be over,” said Mr Cameron on June 18th. “The British people will have a clear choice. A choice between two different visions of society...And a choice between the new and the old politics. Us against Gordon Brown.”

The choice does not, it seems, include the possibility of complete sentences: much of Mr Brown's speech as he assumed the leadership of the Labour Party on June 24th was similarly verb-free. But everything else is up for grabs.

Mr Brown promises fresh policies and a new, more inclusive style of government—a curious pledge for a man who played a crucial role in the last one, and was famed as a closed and clannish operator. Mr Cameron, who is trying to wrench his recalcitrant party from the unelectable right field towards the centre, promises to be more Blairite than Mr Blair, to say nothing of Mr Brown. Mr Cameron is betting that under Mr Brown Labour will lurch to the left; Mr Brown is hoping that Mr Cameron's Conservatives will collapse under the weight of their internal disunity.

Thanks to coincidental Tory disarray as well as to a “Brown bounce”, Labour no longer trails the Tories badly in the polls: Mr Brown and Mr Cameron are running neck-and-neck (see chart). There is implausible but exciting talk that the new prime minister will call a snap election. Politics in Britain is about to get intensely interesting.



What happens as a result of this gloves-off tussle matters, and not only to Britain. New Labour has done well by the country, building on its predecessors' work. Stable economic growth has created 2.5m new jobs and pushed GDP per head above the figures for Italy, France and Germany. There have been social gains as well: fewer children and pensioners live in poverty than ten years ago. Crime is broadly lower. Society is officially more tolerant of difference than it was, thanks to anti-discrimination laws. And as a result of massive investment in public services and some reform of them, health care and education are better than they were, though still less good than they should be.

With prosperity has come renewed political influence abroad. Britain's much-vaunted role as the bridge between America and Europe creaked near-fatally under the weight of the war in Iraq. But the country remains a halfway house between the naked free-marketry of the former and the social safety nets of the latter; its experience offers lessons, perhaps, for both. And as the one big country in the EU to open its labour market to workers from most of the new member states, Britain's future direction may be more important in forging a new European identity than any number of constitutional mini-treaties.

And the greatest of these...

Mr Brown and Mr Cameron are now at war, and style, policies and electoral arithmetic all have a part to play. Start with style, for most voters do.

Mr Blair, once he had shed the wide-eyed sobriquet “Bambi”, was consistently seen by Britons as both “strong” and “charismatic”. Mr Brown has inherited his perceived strength, and Mr Cameron has bagged his charisma. “Dave” comes across as a sports car, fast and faintly glamorous; Mr Brown as a tank with a maximum, crushing speed of 37 mph.

Of course style is superficial, but it influences whether people like a leader, and whether they can or want to identify with him. It also affects his ability to communicate a message. Mr Brown's speeches, packed with relentless fact and analysis, are better than most give him credit for. But even those who are sympathetic start checking their BlackBerrys at around minute three. Mr Brown may have something to say, points out John Curtice, a psephologist at Strathclyde University, but can he get anyone to listen? Mr Cameron has no problem holding people's attention for his *Zeitgeist*-infused pronouncements, but has he anything really to say?

Style hints at substance, too. Mr Brown prides himself on coming up, triumphantly, through state schools and having his sight saved by the National Health Service (NHS). He lives modestly, refuses to dress for formal occasions and speaks urgently of moral imperatives. A modern-day Roundhead, he laboured to shine next to the extroverted, bopping Mr Blair, who saw nothing wrong with big money as long as everyone had a crack at making it.

Mr Brown is now deeper in Cavalier territory with Mr Cameron, who adds to the political disadvantages of an Eton education a suspicious readiness to don plus-fours on shooting weekends. Mr Cameron's tone is one of sweet reason, his message an inclusive one of trust—in society and its institutions, and in people.

Make no mistake: both have good brains. Mr Brown's intellect has been legendary since his precocious youth. Mr Cameron was a slower starter but left secondary school “almost an intellectual”, one master is alleged to have said, and went on to win a widely expected first-class degree at Oxford. There are no dummies in this face-off. But each has other weaknesses, which the fight for the centre ground in politics is revealing.

Common wisdom holds that politics in Britain is no longer the ideological free-for-all it was. Competition is not about fundamental positions but about who can best deliver an agreed bill of goods.

It may, of course, be premature to bury issue politics. In recent weeks the disarray of the Tory party over its leader's explicit rejection of grammar schools for able state students, once an article of Tory faith, exposed the strong tug to the right that the party still feels. Similarly, the campaign for deputy Labour leader—which, since Mr Brown was unopposed, was the only contest in which that party could express its political preferences—rewarded left-wing rhetoric. Harriet Harman, who won it by a whisker, appeared to criticise the war in Iraq and spoke up more heatedly than most for the downtrodden.

But such differences of opinion are a far cry from the wild antagonisms within and between parties 25 years ago. Having helped free his party from its unappealing socialist baggage, Mr Brown will defend the centre ground. Mr Cameron is no less determined to carry his party on to that terrain. And there they are knocking heads over the “Blair legacy”.

What exactly this legacy consists of will no doubt take decades to define. In its essence, it is to have humanised Margaret Thatcher's lean, competitive free-market policies with measures to temper their effect on the vulnerable. It includes, most importantly, a model for delivering improved public services that depends on greater private-sector participation to provide choice and competition (and, to start with, a huge amount of cash).

For Mr Brown, the legacy is, if not a poisoned chalice, at best a mixed inheritance. His reputation stems from his successful management of the economy—though his successor at the Treasury may find that the beat has grown harder to handle (see article). He has kept the bulk of the party behind him by remaining publicly ambivalent about any number of policies for which he was in fact the paymaster: conspicuously, market-oriented reforms of the public services, and the war in Iraq.

To hop or not to hop

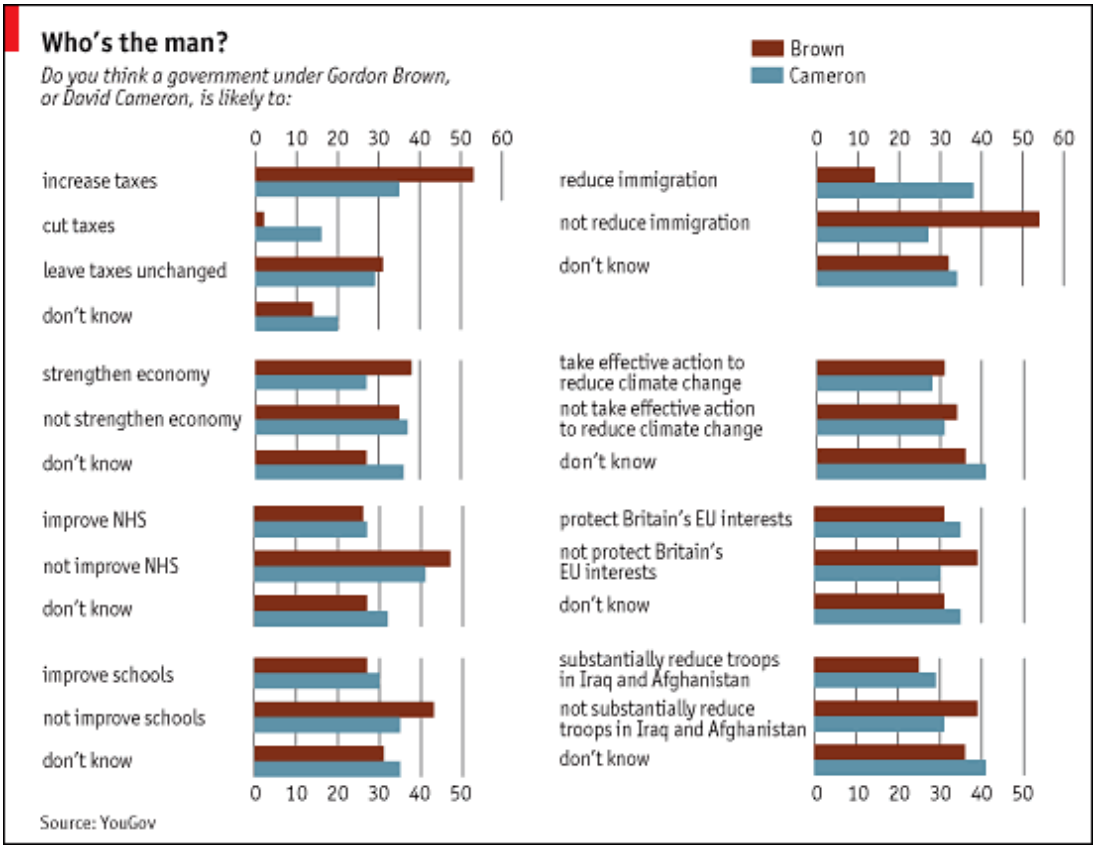
Now he must define himself, and the Tories expect him to hop left. But he has served notice that he will not be portrayed as a roadblock to reform and forced off the centre. Recently he has affirmed his enthusiasm for Mr Blair's pet project: city academies, semi-autonomous schools with backing from businessmen and others.

The broader challenge is to relaunch the government of which he has been the second most powerful member from the start, distancing himself from unpopular policies such as Iraq and health-care problems while pledging more and better versions of the rest. And he has little money with which to do it: public spending has been growing at 4.5% a year in real terms since 2000 but is set to grow at only 2% from 2008. Finally, Mr Blair leaves office a widely distrusted man (though he still beats Mr Cameron and Mr Brown as most Britons' preferred drinking buddy, according to a YouGov poll). Rebuilding trust is a priority for his successor.

Mr Brown has chosen to repackage where money is required, strike out boldly where it is not and speak movingly of traditional values where neither will suffice. His message on health and education is the “personalisation of services”: people must have better access to general practitioners, for example, and education must be shaped around the needs of the child. On Iraq, he shows no sign of pulling British troops out precipitately but indicates a certain sympathy with those who think he should by promising to get rid of the ban on demonstrations outside Parliament.

Most interesting are his pronouncements on three other issues: housing, constitutional reform and how he plans to run the government. Rightly identifying today's terrifying house prices as a source of angst across a wide swathe of the population, he pledges to get more homes built. Reform of the House of Lords went off half-cocked when Mr Blair lost what interest he had in it. Mr Brown says he will move on the matter and—just as important—increase the powers of the House of Commons so that it becomes a more effective check on the executive.

If this sounds astonishing from a man whom Britain's top civil servant once called “Stalinist”, there is more. There will be an end to “sofa government”—a swipe at Mr Blair's habit of cosily stitching up policy with his closest cronies rather than in carefully minuted discussions in cabinet. Mr Brown plans a government of all the talents, he says. On June 28th he named a young, doveish former rival, David Miliband, foreign secretary; appointed the first woman home secretary, Jacqui Smith; and sent his own lieutenant, Ed Balls, to education. The Treasury will still be run by a Scot, Alistair Darling.



The risk for Mr Brown is that he cannot suspend popular disbelief forever: he must produce some tangible new goods or in time be tarred with New Labour's old failures. For Mr Cameron, the calculation is different. To be seen as the "heir to Blair" is a less nuanced electoral winner: successful politicians rarely come to power promising huge breaks with present programmes, especially when they seem to be working.

Rather than firm policies, Mr Cameron has espoused issues involving greenery, localism and social responsibility in place of big-state solutions. He has stayed clear of the usual Tory promises of tax cuts, and been self-consciously liberal on law and order and immigration, the Tories' strident tone on which helped ensure their defeat in the 2005 election. Such policies have failed to remove negative perceptions of the Tory party but failed to create positive ones: no longer hated, it is not yet loved.

Mr Cameron's main job, points out Vernon Bogdanor of Oxford University, is to convince people that the public services are safe with him, as 50 years ago the people entrusted Labour's new welfare state to Churchill and Macmillan. He has been unstinting in his efforts, praising the health service to the skies and vowing that his children will attend state schools. It has paid off in the opinion polls.

But he does have another problem. No opposition party wants to put forward detailed policies too far before an election—and under Britain's parliamentary system the new prime minister can call that election any time between now and May 2010. If it does, people who warmed to the general concept of localism will start worrying about having to repair their own roads, and budding greens will object to swingeing fines for littering. And, of course, the government will pinch the best ideas.

The danger in delaying is that Mr Cameron's incipient reputation as a lightweight—especially against the musclebound Mr Brown—will grow. On June 26th a hitherto little-noticed Tory MP defected to Labour, accusing Mr Cameron of "superficiality, unreliability and an apparent lack of any clear convictions". The policy commissions that Mr Cameron set up to ponder elements of a party platform are beginning to report back. That should nudge the process forward, but the result already threatens to be incoherent.

Counting heads

Mr Cameron and Mr Brown are embarked on a battle for Middle England, a legendary land that is hard to find and harder still to talk to. Mr Brown "doesn't get" modern Britain, says Mr Cameron. In fact, neither has the feel for the crucial upwardly mobile floating voters of England's metropolitan suburbs that Mr Blair or Lady Thatcher had. Mr Brown is just too Scottish (see article) and Mr Cameron, with his privileged

background, has yet to register much north of Birmingham.

With Mr Blair's departure, the prospect of the next election is suddenly looming larger. Only the Conservatives have won more than three consecutive terms in office since the Napoleonic wars. Mr Brown has no mandate—not even from an internal vote in his party—and would surely love to have one. But he does not want to prove a fag-end prime minister like Jim Callaghan, plunging to defeat the minute the voters get a voice.

Polling pundits say they would advise him to go to the country this autumn. Having waited this long for greatness, Mr Brown may not want to cut short his time in the sun. But he is also a prudent man, and only a foolhardy one would leave his fate to be determined by the mood of the last moment. So Mr Brown will call an election as soon as he thinks he can win it.

And when might that be? As the chart shows (on polling carried out for *The Economist* by YouGov), neither contender fills people with enthusiasm. Mr Brown is expected to produce a stronger economy than Mr Cameron but not much else. Confidence that either would produce desirable change is low. Mr Cameron is liked but has yet to show himself a decisive leader who could cope in a crisis. Mr Brown is seen as strong and experienced, but dull, and author of many of the woes he says he wants to correct. Mr Cameron's strolls through corner shops, Mr Brown's attempts to “listen and learn”, are both dismissed as spin. The election, whenever it comes, is probably Mr Brown's to lose. But Mr Cameron may be resourceful enough to snatch the advantage.

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Economic prospects

Debt hangover

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From The Economist print edition

Gordon Brown may come to rue the economic legacy he left as chancellor

ALTHOUGH finance directors often become chief executives, the same is not true in politics. More often than not, the tricky job of managing the country's economy and the public finances wrecks promising careers. Gordon Brown is an exception because he presided over a decade of continuous growth and low inflation. Yet the economy, which has been his making as chancellor, could prove to be his undoing as prime minister.

As far as growth is concerned, it is business as usual. The economy continues to rattle along, helped by a recovery in Europe, a resurgence in business investment and indomitable consumers. In another sign of economic health, Britain continues to top the European league table for inward-investment projects, according to Ernst & Young, an accountancy firm.

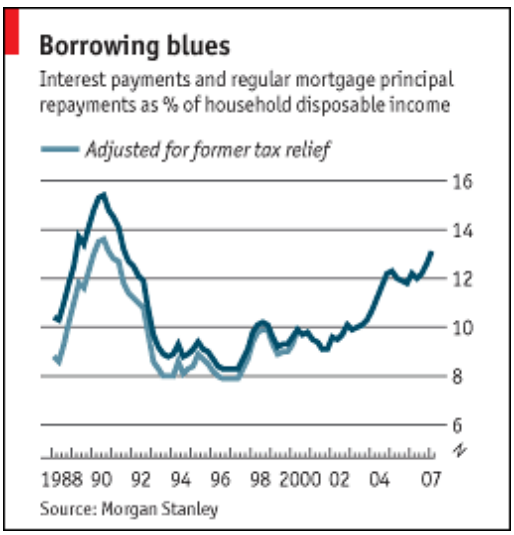
Inflation is back, however. Retail prices rose by 4.8% in the 12 months to March, the most for almost 16 years. That surge in inflation, driven by higher home-energy costs, is now receding as gas and electricity prices come down. But underlying inflationary pressures remain uncomfortably strong because the long period of sustained growth has left the economy operating close to its capacity.

The Bank of England has responded with some unpalatable medicine for borrowers. Since last summer the bank's monetary-policy committee has raised the base rate from 4.5% to 5.5%. Four of the nine rate-setters wanted a quarter-point rise this month, according to minutes published on June 20th. This suggests that an increase to 5.75% in early July is highly likely. The City is pricing in another rise after that, taking the rate to 6.0% by the end of the year, and there seems little chance of any easing in 2008.

Household budgets have already been squeezed hard in recent years by rising taxes and higher inflation. Real disposable income grew last year by just 1.3%, the slowest since 1982 and less than half its average rate in the past two decades. So far this year, retail-price inflation has outstripped increases in average earnings, leaving workers worse off.

Some relief will come over the next few months as inflation subsides. Treasury forecasts also suggest a more moderate rise in the exchequer's take from income taxes in the year ahead. But now household finances are being strained by the remorseless rise in interest rates. People who took out two-year fixed mortgages at low rates in 2005 are facing a particularly painful shock as they absorb the full increase in borrowing costs over the past year.

According to Morgan Stanley, an investment bank, debt-servicing costs are at their highest as a share of disposable income since the recession of the early 1990s (see chart). Mortgage borrowers used to get generous tax relief on their interest payments but this was phased out during the 1990s and abolished in 2000. When this is taken into account, the debt-servicing ratio is close to its previous peak when the base rate stood at 15%.



The borrowing binge of the past few years explains why people are having to shell out so much even though interest rates are still far lower than in the early 1990s. Since 2000 household debt has soared from 110% of disposable income to 160%. Taking on bigger loans seemed affordable when credit was cheap. But now borrowers are saddled with higher debt repayments and are vulnerable to relatively small increases in interest rates.

The heavier burden of debt-servicing costs will constrain consumer budgets over the next year or so. Furthermore, although house

prices are still rising fast—they increased by 11% in the year to June, according to the Nationwide building society—higher interest rates should eventually cool the market. As this happens, consumers will be less ready to borrow against the value of their homes in order to maintain their living standards.

The willingness of households to pile up debt buttressed the growth in consumption and overall demand during the past few years. In effect, however, it brought spending forward. Now the danger is that consumers will have to retrench, leading to a nasty economic slowdown.

As chancellor Mr Brown derived invaluable political capital from running a stable economy. But the legacy that he both leaves and inherits has drawbacks. As prime minister he will have to cope with more austere times and deal with a debt hangover that threatens to devalue his political stock.

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Floods bring disaster to Britain

If Canute could see us now

Jun 28th 2007
From The Economist print edition

UNP

Four people died, thousands were evacuated, bridges collapsed, transport was disrupted and the army helped out as torrential rain overwhelmed Victorian drainage systems in many parts of Britain, including Sheffield. Engineers worked through the night on June 26th and 27th to pump water out of the Ulley reservoir in Yorkshire, amid fears that its dam might burst. Following the warmest April, and second-coldest day in May, ever recorded, some areas saw an entire month's-worth of rainfall on June 25th. Insurers gave warning that the cost could run as high as £1 billion ($2 billion). A tenth of all houses are now believed at risk of inundation. The government plans to build hundreds of thousands more on flood plains, despite warnings that such “extreme” weather conditions will become increasingly ordinary as the climate changes.

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Religious conversion

Many mansions

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Changing church to find a better fit

AP

"POLYTHEISTIC, degrading and idolatrous": that was how John Henry Newman described Catholicism after visiting Rome in 1833. Later in life he revised his views, converting to the faith in 1845 and becoming a cardinal in 1879.

When Tony Blair travelled to Rome for an audience with Pope Benedict XVI on June 23rd, he brought antique photographs of Newman as a gift—an appropriate gesture to signal imminent conversion to Catholicism. At least on doctrinal matters, he will have no harsh words to recant. He is deeply familiar with the faith; he regularly attends Mass with his wife, Cherie, a cradle Catholic; and he sends his children to one of London's best-known Catholic schools.

Converting from Anglicanism to Catholicism is not common—only 3,981 adults were received into the Roman church in England and Wales in 2005 (the most recent figure available). It is a low number for a country where 1m attend Mass each Sunday, 4m are Catholic by background (however fuzzy their beliefs may have grown) and congregations have been boosted by an impressive influx from pious places like Poland.

Some people switch their allegiance to Rome simply because they want to marry a Catholic, or to make life easier after they have already married one, says Francis Davis of Cambridge University's Von Hügel Institute. Others are attracted by the church's hard line on divorce, contraception and homosexuality, or are seeking refuge from moral relativism in a religion which promises certainty—even, in some circumstances, infallibility.

Whatever attracts Mr Blair, it does not seem to be doctrinal rigidity. When the late Cardinal Basil Hume asked him to stop breaking the church's rules by taking communion with his wife (in defiance of the ban on communion for non-Catholics), the prime minister retorted: "I wonder what Jesus would have made of it?" Nor has he been drawn to Rome by his conservative leanings on social issues; his government introduced civil partnerships for gays and gave generous funding for stem-cell research. Indeed, during his recent visit to Rome, it was politely but firmly pointed out that that his record in office was hardly that of a conscientious Catholic.

More attractive to Mr Blair is probably the Roman church's vast international reach and professed interest in the poorest people in the world. Catholic activists may sometimes line up with opponents of economic globalisation—but the Church is itself a global agency with a view on everything that goes on in the world. And although he shows little sign of having a sense of the mystical, Mr Blair has an intense curiosity about matters theological, including the questions which divide Christianity from Islam. In a country that is embarrassed by open allusions to faith, he once startled a television interviewer by saying that he would be judged by God over the war in Iraq.

As recently as 50 years ago, when Catholicism seemed exotic and alien to the British mainstream, conversion to Rome created a certain *frisson* which celebrity English converts—such as the writers Evelyn Waugh and Graham Greene—may have half-consciously relished. Perhaps today's equivalent is conversion to Islam, a route taken by about 14,000 Britons, according to one estimate: they range from dons and diplomats who embrace Sufi mysticism to angry inner-city youths who see in radical Islam a way of rejecting authority with a vengeance.

In modern Britain, though, the most striking schism is between those of faith—any faith—and those of none. In the face of secularism, believers make common cause, rather than emphasising doctrinal

differences. On one side of this divide is Prince Charles, who has let it be known that on becoming king—and therefore head of the Anglican church—he would like to take the title “Defender of Faiths”, rather than, as is traditional, “Defender of the Faith”. On the other is Richard Dawkins, author of “The God Delusion”, who claims that moderate believers make the world safe for fundamentalists. Nowadays, rather than seeking salvation, those who convert between religions may just be looking for a more congenial home.

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Youth gangs

Danger in numbers

Jun 28th 2007 | LONDON AND BRISTOL
From The Economist print edition

Teenage gangs are deadly but surprisingly flimsy

TEXTING someone else's girlfriend, gatecrashing a party, hailing the wrong person in the street: these innocuous offences are all said to have provided teenagers with motives for murder. Four fatal stabbings and one shooting shocked London this week, while in Manchester a 19-year-old was jailed for blasting a youth in a trivial row. A recurring factor, besides senselessness, was gang membership.

How many young people belong to gangs? When the Home Office last counted in 2004, it found that 6% of 10-to-19-year-olds belonged to a "delinquent youth group". Membership was highest among those aged 14 and 15, of whom 12% were signed up. But most members were tame. The Home Office's understanding of delinquency includes smoking cannabis and "frightening people", which some teenagers do without trying. Fewer than a third of them were frequent offenders, and only one in eight had carried a knife. Gunmen numbered fewer than one in 100.

London Police Press Bureau

Martin Dinnegan: killed, and for nothing

Nonetheless, flares of sickening violence are making people wonder how prolific this mad, bad minority must be. Much teenage crime slips under the radar because victims under 16 are ignored by the British Crime Survey (BCS), the government's favoured index. But police figures unearthed by the Tories show that 29% of mugging victims last year were 11-to-16-year-olds. Some 40% of the alleged perpetrators were themselves under 16. And some say the BCS underestimates violent crime—by 45%, according to a report on June 26th from Civitas, a think-tank.

Gangs are not the cause of this youth offending, argues Enver Solomon of King's College, London. "There's some evidence that young people will act with another when approaching someone to pinch their iPod. But it's usually in ones and twos, not packs," he says. And some child "robbers" are just old-fashioned bullies, he points out: the difference now is that they nick mobile phones, not sweets.

Bullying may be as far as many young louts go. But gang membership exposes them to disproportionate risks. "In a gang of 30 you might have one or two who are particularly hard or a bit crazy, who might use firearms or do a series of robberies," says Robert Ralphs of Manchester University, who has interviewed gunmen as young as 14. Most members may only deal a little cannabis, but their association with the hard cases makes them targets for rival gangs looking to settle scores.

The consequence is that even minor players get armed. Mum's kitchen is a good starting point. But even firearms are within reach. New handguns, smuggled from Europe by car or in the post, are scarce and cost up to £500 ($1,000). But once fired they are a liability that older gangsters gratefully offload to teenagers for as little as £50. Police seizures suggest that more than half the guns on the streets are converted (and dangerous) replicas, a fact to which many younger gangsters seem oblivious.

Control of the lucrative drug trade once made the danger seem worthwhile. Bristol's worst gang violence erupted in 2003, when Jamaican newcomers clashed with British Afro-Caribbeans for control of the local crack-cocaine market. Inspector Dave Bradnock, who helped to put the kingpins behind bars, says the old gangs are less active now. The "Aggi crew", once key players, are out of prison but seem to have hung up their weapons.

Good policing is one reason, but drug dealing has also become less appealing. The relentless spread of drugs means in most cities it is impossible for one gang to control supply. Average prices have fallen:

ecstasy tablets, for example, now cost less than a third what they did a decade ago. Mr Ralphs says the impact on gangs is obvious. Walking around with older ex-gang members is “like being out with David Beckham. People stop to shake their hand.” The current generation makes a sorry contrast. “They say they make £1,000 a week, but they have to put their money together to buy a £20 bag of weed.”

It is hard to imagine anyone choosing such a wretched life. In fact, it seems few choose it at all. The Home Office found that most gangs had no leader and only a third even had a name (Bristol's “Aggi” crew, sweetly, is named after its founders' initials). The only common feature, mentioned by nine gang members out of ten, was a regular territory or meeting place. If this is a gang's only durable characteristic, breaking it up ought to be as simple as providing somewhere better for young people to hang around.

Understanding the makeup of gangs also counts. A report last month from the Metropolitan Police Authority described community anti-gang efforts as “almost exclusively focused” on Afro-Caribbeans. Yet of 171 current London gangs, only half were predominantly black, it pointed out. Martin Dinnegan, the white 14-year-old stabbed to death on June 26th, was not everyone's idea of a typical gang victim. If people can realise his case is not so unusual, there may be fewer like him.

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London Underground

Down the Tube

Jun 28th 2007
From The Economist print edition

London's troubled Tube contract goes to arbitration

Get article background

AS A present to an incoming prime minister, it leaves a lot to be desired. Four years ago, as chancellor, Gordon Brown forced through a controversial public-private partnership (PPP) deal to upgrade London's Underground system over the objections of Ken Livingstone, the city's mayor, and Bob Kiley, its transport chief. This week, as Mr Brown at last moved into Britain's top job, the scheme is back in the news, for all the wrong reasons.

On June 21st Metronet, the company that is responsible for nine of the Tube's 12 lines, announced that it would be asking the PPP arbiter, Chris Bolt, to decide who should pay for roughly £1 billion ($2 billion) of cost overruns incurred on three of its lines. The request is the culmination of a row that has been brewing for months. Transport for London (TfL) has criticised the company for falling behind on station upgrades, allowing engineering work to run over into the morning rush hour, and elementary errors such as failing to prepare rails for hot summer weather. TfL's words have become fiercer with time: such incidents, says the most recent report, “completely undermine...our confidence in the capability of Metronet's management”.

Metronet argues that much of the cost overruns arise from work that is beyond that specified in the contracts. It points, for example, to an unplanned £80m refurbishment of trains on the Central Line, following a derailment just before the firm took over. Such justifications cut little ice at TfL, which says pointedly that TubeLines, the other PPP contractor, has managed to stay generally on time and on budget. Accordingly, TfL has rebuffed Metronet's suggestion of a negotiated settlement. “We aren't going to hand over more public money to an outfit that can't explain what it's done with the first lot,” insists a spokesman.

Mr Bolt will take around a year to decide who should pay what, although he will make a preliminary judgment much sooner. Under the terms of the PPP, he will compare Metronet's performance with that of a “notional firm” that acts “economically and efficiently”. Any overspend that meets these criteria is paid for by TfL; any that arises from waste and inefficiency is the responsibility of the firm.

Things already look ominous for Metronet. In an earlier report, published in November, Mr Bolt said that, in general, the company had been acting neither economically nor efficiently. Most observers—including, it seems, the firm's backers—think Metronet will be faced with a substantial bill. Its banks have refused to release more money; two of Metronet's five shareholders (WS Atkins and Balfour Beatty) have announced losses of £121m and £100m respectively on their stakes in the company. In the nightmare scenario, a big payout could encourage Metronet's shareholders to walk away from the contract, although optimists hope that the embarrassment caused by such a move will convince them to stick it out.

But taxpayers are unlikely to escape scot-free. Unless Mr Bolt rules that every penny of the overrun is due to Metronet's incompetence—which most experts think unlikely—TfL could have a substantial cheque to write as well.

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Bagehot

Jock v Posh

Jun 28th 2007
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Steve O'Brien

The ways in which it does not and does matter that the new prime minister is Scottish

Gordon Brown

MOST English intellectuals, George Orwell observed, would rather be caught stealing from a poor box than seen standing to attention during the national anthem. Likewise, until quite recently few politicians of the left publicly wrapped themselves in the Union Jack. Yet when Gordon Brown assumed the leadership of the Labour Party from Tony Blair last weekend, there it was, looming red-white-and-blue behind them as they momentarily gestured towards a hug, then settled on a handshake.

War abroad, and worries about terrorism at home, have helped to make public shows of patriotism virtuous. But there is something else. As prime minister, Mr Brown can change Britain's foreign policy and its constitution ("Let the work of change begin," he said as he entered Number 10, apparently intent on using the "c" word in every sentence). He cannot, however, change his own biography. Mr Brown is Scottish—and he knows it. Like gender, his and others' Scottishness was one of the considerations that he had to balance when forming his cabinet this week. And if it was a concern at the beginning of his premiership, it may be a bigger one when he actually faces an election.

Not, mainly, for the reason that most interests the commentariat, which is the constitutional puzzle catchily known as the West Lothian question. The conundrum is, now that they have their own devolved assemblies, why Welsh, Northern Irish and especially Scottish MPs get to vote on legislation that affects only England, when English ones have no say on such matters in their domains. This imbalance looks especially unfair when the government relies on those Scottish MPs to get its English legislation through Parliament. It will be even less defensible should Mr Brown or a future Labour leader command an overall majority in Britain, but not in England. And even the most sanguine Englishman might squawk if—despite his rejection last week of posts in Mr Brown's government, and assuming he is still the leader of the Liberal Democrats—a deal with Sir Menzies Campbell, a fellow Scot and friend, one day keeps Mr Brown in office.

The trouble with the West Lothian question, like many good questions, is that it has no good answer. Devolving more power to the English regions, for example, might help, except that the English are not conspicuously keen. The idea, espoused by the Tories and others, of letting only English MPs vote on English matters, might in practice produce rival parliamentary majorities, deadlock and chaos. The good news for Mr Brown is that, although the English consciousness has been poked into life by devolution and

immigration, finding an answer is not all that urgent. When asked, most English voters say the status quo is wrong, and, sometimes, that a man from a Scottish constituency ought not to be prime minister. But most are oblivious; and, as their fixation with Europe proved, pushing a pet issue at the expense of others would discredit the Tories as much as Mr Brown.

More damaging is the fact that the devolved Scots now enjoy important perks, such as some paid-for medicines and (soon) free university education, that the English don't—preferential treatment that violates a deep if illogical English expectation that government should treat everyone everywhere the same. Worse, the Scots can afford these perks in part because they receive more public funding per head than the English. The resulting sense of being short-changed corresponds to an ancient English stereotype about tight-fisted Scots, one of the few prejudices that is still broadly permissible. Mr Brown's own long-cultivated image as the groom of Prudence has drawn on the stereotype, but in a benign way; if disgruntlement over the disparity grows, feelings towards the top Scot might be less benign.

The obvious solution—cutting the Scottish subsidy—would exacerbate another problem, known as Alex Salmond, leader of the Scottish nationalists. His elevation last month to first minister of the Scottish Parliament was as painful a coincidence for Mr Brown as the defection this week of a Tory MP was fortuitous. Cuts would help Mr Salmond demonise Westminster in general, and Labour in particular—and whereas relying on Labour MPs from Scotland for a majority would be awkward, having no majority at all if there were fewer of them would be worse.

And Dave is from Venus

But again, although Mr Salmond's snarling showmanship may conceivably lead to the break-up of the union, it is unlikely to cost Labour an election. Few people in England listen to him; and improving England's public services in general is vastly more important than simply matching the Scots. The real medium-term risk for Mr Brown is subtler, and perhaps even less soluble.

It is that his Scottishness will reinforce the view that, even more than most politicians, Mr Brown is a sort of intellectual Martian. In fact, with his state-school education and up-by-the-bootstraps philosophy, he can arguably claim to have more in common with some of the semi-mythical denizens of Middle England than did suave, metropolitan Mr Blair. But, for all his lusty support of England's football team, he is not one of those deracinated upper-caste Scots with scarcely perceptible accents. Especially in the marginal south-eastern constituencies that are dearest to his heart, people may listen when the Tories ask, does this son of the Kirkcaldy manse really understand us? Wave the flag as he may, does he really get our small business, our “alternative” lifestyles, our aspirations (another current buzzword) and our enormous mortgages?

Mr Brown's best comeback may be to exploit another, still more permissible prejudice: against posh people. David Cameron, the Tory leader, is not aristocracy, but with his Eton education he is posh enough for caricature. If real ideological oppositions—big versus small state; high versus low tax—are truly dead, cosmetic divides will replace them. This contest of prejudices, Jock versus posh, may be one of them.

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The opium economy

A world awash in heroin

Jun 28th 2007
From The Economist print edition

AP

And much of it from one unruly region of Afghanistan

THE smell of the Afghan poppy season is unmistakable, even from the open door of a Black Hawk helicopter. NATO Soldiers in Helmand province see the expanse of purple and pink blossoms flashing by, but they do little to stop drug production; they worry instead about Taliban fighters mingling among the villagers, and are grateful to avoid being shot down.

Yet the opium economy and the insurgency are mutually reinforcing; drugs finance the Taliban, while their violence encourages poppy cultivation. Not surprisingly, perhaps, both problems have grown more severe in recent years, nowhere more so than in Helmand.

According to the United Nations Office on Drugs and Crime (UNODC), the province is set to harvest another record crop this year, producing more opium (and from it heroin and other illegal drugs) than the rest of Afghanistan put together. Indeed, this surge has overshadowed the past decade's striking decline in the “Golden Triangle”—the border region of Thailand, Myanmar and Laos—which UNODC says is “almost opium free”.

Afghanistan has put a blot on what UNODC says is a hopeful global picture. Its latest “World Drug Report”, published on June 26th, says that the market has largely stabilised for all classes of illicit drugs—including heroin, cocaine, amphetamines and cannabis. The global area under cultivation for both poppy and coca has declined over the past decade, although improving yields mean opium production has reached record levels while cocaine remains steady. Demand for opiates and cocaine is stable. Moreover, UNODC reckons that a startling 26% of global heroin production and 42% of cocaine output has been intercepted by government authorities. Meanwhile, cannabis cultivation in Morocco, the source of 70% of hashish in Europe, has dropped. World production of amphetamines and similar stimulants appears to be steady.

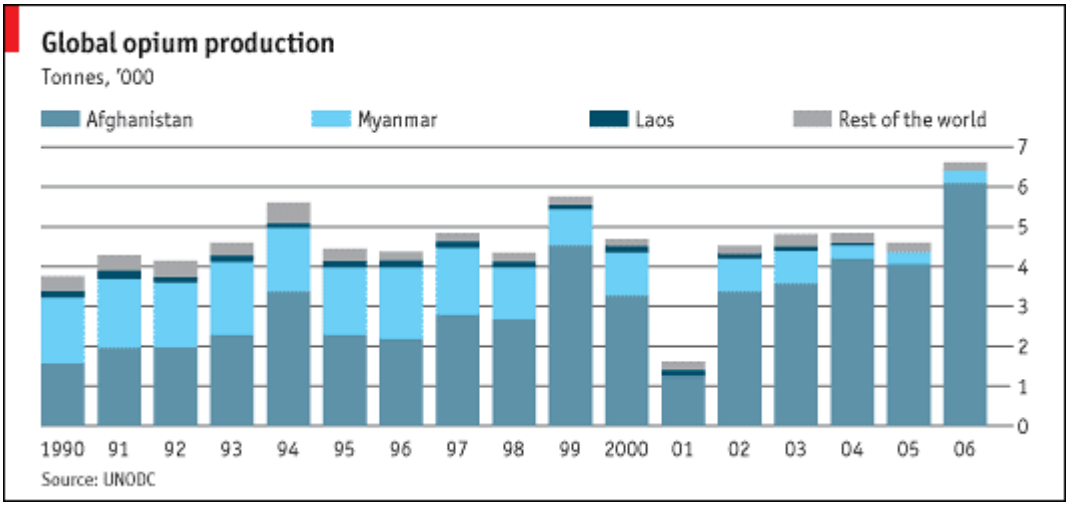
The drugs business is by far the most profitable illicit global trade, says UNODC, earning some $320 billion annually, compared with estimates of $32 billion for human trafficking and $1 billion for illegal firearms. The runaway Afghan opium trade—worth around $60 billion at street prices in consuming countries—is arguably the hardest problem. Heroin is finding new routes to the consumer, for instance through West Africa to America, and via Pakistan and Central Asia to China.

The opium market puzzles experts. They say there is now an over-supply of opiates, but the price for farmers or drug users has not changed much. UNODC suspects opium is being hoarded, and that

traffickers are squeezing their vast profit margins and increasing the purity of heroin doses to maintain stability.

At the time of the 2001 war in Afghanistan, the Taliban were blamed for presiding over widespread poppy cultivation. Yet they did impose a successful but short-lived ban in 2000. Their Western-backed successors have been less able to stop the inexorable spread of poppy farming. These days, says NATO, Taliban commanders and drug smugglers are often one and the same.

Afghanistan last year produced the equivalent of 6,100 tonnes of opium, about 92% of the world total. There is an interesting divergence: in areas controlled by the government, production is either decreasing or stable (or even poppy-free); where the insurgency is strongest, it is for the most part increasing.



Nevertheless, the impact is felt throughout Afghanistan. The opium trade is worth about $3.1 billion (less than a quarter of this is earned by farmers), the equivalent about a third of Afghanistan's total economy. It has forced up the exchange rate, sucked in unproductive luxuries and stoked a boom in construction, particularly around Kabul. In a country as poor as Afghanistan, opium rots any institution it touches. Some of the biggest drug barons are reputedly members of the national and provincial governments, even figures close to President Hamid Karzai. The whole chain of government that is supposed to impose the rule of law, from the ministry of interior to ordinary policemen, has been subverted. Poorly paid policemen are bribed to facilitate the trade. Some pay their superiors to get particularly “lucrative” jobs like border control.

Despairing of the failure of the anti-narcotics effort, formally led by Britain, which has focused on seeking alternative livelihoods for poppy farmers, the United States has been pushing for a more aggressive eradication campaign with aerial spraying. Its experts say that incentives alone will never work when farmers can earn eight or nine times more from poppy than from wheat. “You need a stick as well as a carrot,” says one senior American official. To show that aerial spraying works, the Americans point to UNODC's estimated 52% reduction in coca cultivation (but not cocaine output) in Colombia since 2000. However, European governments and many military commanders strongly oppose such draconian measures, fearing they will drive even more Afghans into the arms of the Taliban.

American officials were outraged last April when British commanders used a local radio to tell Helmand villagers that foreign and Afghan troops “do not destroy poppy fields” and “do not want to stop people from earning their livelihoods”. At military checkpoints, British soldiers assure passing Afghans they are there for reconstruction, not eradication, and they often turn a blind eye when they find opium.

President Karzai has so far allowed only limited destruction by hand or with tractors. But this cautious approach has arguably made matters worse in places like Helmand. The discretion allowed to local government and police officials to choose which fields should be destroyed turned last February's eradication effort into a “harvest of money” as some Afghans called it. Wealthier or better connected farmers bribed police to spare their crops. Poorer farmers bore the brunt, while some of the nastiest warlords-cum-druglords were hardly touched.

Some 500 police officers, backed by American security men with helicopters, raked in about $3m, according to some officers. They were supposed to destroy 12,000 of the estimated 100,000 hectares of poppy in Helmand. They claimed 7,000 hectares had been ripped up, but the UN verified only half this

amount. Ordinary policemen averaged $1,000 each in backhanders. “We do a dangerous job and we get $70 salary a month,” said one, “If we are killed there is no money for our families. We just have to make money while we can.” One police colonel is said to have treated himself to a new Lexus car.

Can Afghanistan learn from the successes of other countries? Thailand rid itself of poppy by an active policy of encouraging alternative economic development. But through the 1980s and 1990s it enjoyed strong economic growth driven by tourism and exports, and a fairly stable government. A lobbying group known as the Senlis Council says Afghanistan should copy Turkey and India in licensing legally poppy farming to make painkillers, such as morphine and codeine. This would draw farmers away from the drug barons and the Taliban, provide a source of income and improve skills by helping farmers to make painkiller tablets in their own villages.

The Senlis Council argues that a large unmet need for painkillers could be filled by Afghanistan, particularly if it undercuts other producers. UNODC disagrees. It says there is no shortage of such drugs; the problem is poor distribution and many countries' lack of medical experience in using opiates. In any case, says UNODC, the inability to punish those who break the rules means licensing could increase demand for illegal poppies.

Romesh Bhattacharji, India's narcotics commissioner until 2001, supports the Senlis Council. Pointing to the millions of new cancer cases every year, he argues that too many patients are dying in unnecessary agony. But he also enumerates the difficulties: in India, the government must survey 70,000 farms, suppress illicit cultivation, resolve countless disputes over allocations and prevent the theft or diversion of crops. This may be beyond the ability of a fragile state like Afghanistan.

Another option under discussion is to stimulate licit agriculture, perhaps by guaranteeing prices for non-poppy crops. Afghanistan is, after all, within striking distance of the lucrative markets in the Gulf. But such measures might encourage smuggling of produce from neighbouring countries. In any case, encouraging agricultural exports requires more than higher prices, not least refrigeration, reliable electricity, safe roads, finance, marketing skills and access to markets. Dry opium, by contrast, can be stored almost indefinitely and often acts as a family's store of wealth.

UNODC officials propose some partial steps, including targeting laboratories that convert opium to heroin, taking action against some of the best-known drug smugglers to signal the government's seriousness, and rotating police officers frequently, particularly those in bribery-prone positions such as border posts. Ultimately, though, halting Afghan opium production means reducing demand in Europe and other drug-consuming states. Progress in Afghanistan, if it comes, is likely to be incremental and will involve a mix of eradication, development, stimulating agriculture and licensing poppy. But all these measures require the same elusive ingredient: a stable government that controls its own territory and borders.

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Economist.com WORLD INTERNATIONAL

Laying down religious law

Islam's authority deficit

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From The Economist print edition

Don't count on state-sponsored greybeards to silence all awkward voices

GOVERNMENTS worried by Islamist extremism ought to get the message: the only real answer lay in more Islam—deeper, sounder, more careful readings of the Muslim faith, from scholars who could use the weight of collective experience, accumulated over 14 centuries, to solve the dilemmas of life in the modern age.

Such, broadly, was the argument laid out in London recently by Ali Gomaa, the grand mufti of Egypt, before a gathering of Islamic scholars and pundits. And his hosts took him seriously. The case for using scholarly Islam as a counterweight to the radical, hot-headed sort is familiar in the Middle East, but this time it won an unusually clear endorsement from a Western leader, Tony Blair.

Reuters

Gomaa: he can't do everything

In his parting thoughts (as prime minister, anyway) on Islam, Mr Blair lauded Jordan for its efforts to make the various legal schools of Islam respect each another and stop calling each other infidels. And just like Mr Gomaa, Mr Blair said how important it was to ensure that only qualified people could issue *fatwas*, or rulings on how to follow Islam in specific situations. Emboldened by his welcome, Mr Gomaa offered to help Britain set up a post like his own: state-certified grand mufti.

Britain may never again have a leader with such a personal interest in theology. But the very fact that Mr Gomaa and similar worthies from other Muslim countries were asked to London (formally by Cambridge University, but with keen official encouragement) reflects a long-term dilemma for all Western states with growing Muslim communities.

To stem extremism, should they follow the lead of many Muslim governments and get involved in Islamic affairs—by promoting some clerics (or theologies) over others? One would-be EU member that does so already is Turkey, where a big state bureaucracy regulates mosque-building and religious education, and pens sermons. Similar political controls on religion exist in many Sunni countries. (In Shia Iran, by contrast, religion has top place: the supreme leader is always a cleric.)

So how much hope should governments in any part of the world place in the promotion of “good”—in the sense of moderate and scholarly—Muslim clerics and theologians, as an answer to the bad sort?

This much is true: many of the Muslims who are drawn to jihadist violence, or to strident forms of political Islam, are indifferent to, or ignorant of, the nuances of theology; that makes them susceptible to “amateur” *fatwas*. But as a French scholar, Olivier Roy, points out, it doesn't follow that such people—when presented with sophisticated religious arguments—would change their mind. In many cases, they have a general aversion to the idea of elaborate theology.

A more basic problem is that even in states with no political freedom, no official imprimatur can drown the multiplicity of voices vying to influence Muslim hearts and souls. And the age of electronics has broadened the Muslim market-place.

Modern Muslims seeking a *fatwa* on a practical matter need no longer go to a local mosque, or to the state-salaried officials, or muftis, used by many Sunni Muslim countries as arbiters. (Malaysia has 14 muftis; one for each state.) They can call in to a radio or television show featuring a popular preacher, or use the dial-a-*fatwa* phone service that one Egyptian firm offers. Half a dozen websites in English alone (like efatwa.com, muftisays.com and askimam.com) offer online advice about everything from ablution to

Zionism. A downloadable service, “FatwaBase”, can be used on handheld computers.

Much of the latest electronic guidance is sponsored from Saudi Arabia, and so reflects its conservative mores. More tolerant and mystical versions of the faith, as well as the ultra-puritanism of the Salafist movement, also compete for market share. With piety deepening worldwide, and with state clerics often seen as stooges, the faithful seek out scholarly views that are conservative enough to suit them.

Worried governments are not the only people calling for order in this noisy free-for-all. One of the star competitors—Yusuf al-Qaradawi, who preaches on the al-Jazeera satellite channel—has sponsored the creation of an international council of *ulema*, or religious scholars. As a scholar who is de facto spiritual adviser to the international Muslim Brotherhood, he seemingly contradicts the notion that political Islam and learning do not go together. But it remains true, says Mr Roy, that the Brotherhood's back-to-basics ethos is averse to highbrow theology.

That aversion certainly doesn't hurt, and it may even help, the Brotherhood as it competes with Mr Gomaa to influence Egyptians. As part of this struggle, Mr Gomaa has recently proposed a board to vet *fatwas*, with powers to punish those who issue incorrect or misleading ones.

Yet Mr Gomaa himself is no stranger to controversy. His own *fatwas* have often been challenged by a rival authority, the ancient university of al-Azhar. As a case of the bizarre effects of competition between scholars, take some recent exchanges on female circumcision. More clearly than before, Mr Gomaa laid down on June 24th (after an 11-year-old died under the knife) that it was not just “un-Islamic” but forbidden. Mr Qaradawi, by contrast, has suggested that genital cutting is permissible so long as the clitoris is “reduced in size”, not removed entirely. It says something about the mood of religious conservatism on the Egyptian street that Mr Qaradawi's ruling was seen as “playing to the gallery”.

Abdal-Hakim Murad, an influential British convert to Islam, says the only way to promote good sense and scholarship simultaneously is to have a transnational body of greybeards, free of all political influence. But if governments look to this or any clerical body to provide them with absolute clarity on what Muslims should believe and do, they won't get it: there are just too many interpretations.

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Wonders of the world

Reluctant marvels

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Some sites are strutting their stuff, others are blushing and shy

WHO wants their country's finest monument to be a new wonder of the world? Not everybody, it seems.

Whether they like it or not, seven successful candidates—chosen by tens of millions of electronic votes from every corner of the earth—will be named on July 7th (yes, 07/07/07) at a glittering show in Lisbon. Bernard Weber, the Swiss-Canadian explorer who devised this extravaganza, hopes it will put him on a par with Pierre de Coubertin, the Frenchman who revived the Olympics.

India has used Bollywood glamour to promote the Taj Mahal. Back in 2004, the screen diva Aishwarya Rai oversaw the launch of a balloon, inscribed with an exhortation to vote, which was then tethered to the site—to the horror of aesthetes. Jordan's ancient city of Petra staged folk dances and pageants to highlight its charms.

Elsewhere interest in being a wonder is slacker. When Mr Weber toured Stonehenge, a prehistoric site in England, just a few bedraggled and chilly druids awaited him. And one site has stayed on the list despite local objections: Egypt's Giza Pyramids, the only one of the seven wonders of the ancient world to remain intact. Vying with 20 other johnnies-come-lately is humiliating, the Egyptians say. In Peru, arguments swirl round the eerie ruins of Machu Picchu, a 15th-century Inca city. Boris Gómez, head of tourism in the Cusco region, sees a contradiction: the government says no more than 2,500 people a day can visit the place; but it has also voiced keen hopes that “wonder” status will boost the flow to twice that level. Perhaps we should be saying, “vote for us but don't even think of coming,” he sighs. It's not always wonderful to be a wonder.

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The resilience of freedom

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From The Economist print edition

AFP

After ten years of Chinese sovereignty, Hong Kong's economy is thriving. But politics, says Simon Long (interviewed here), remains a one-horse race

Get article background

THE torrential rain that fell on Britain's end-of-empire parade on the night of June 30th 1997 conjured up apocalyptic visions of the future of Hong Kong. Prince Charles bequeathed a sodden city to Jiang Zemin, China's president, and left on board his yacht with Chris (now Lord) Patten, the last British governor. That very night the city's new masters swore in a new “provisional” legislature appointed to replace one elected under British rule. Television cameramen flocked to the territory's borders with China to film the arrival of the People's Liberation Army. It proved to be almost the last chance to see those soldiers in Hong Kong: they disappeared into their barracks. There were no round-ups of degenerates, dissidents or democrats, and no newspaper closures.

It is tempting to argue that Hong Kong has changed China more than the other way round, as this newspaper and others forecast in 1997. Certainly China has changed the more, though Hong Kong's role in this—compared with, for example, the dynamic momentum of China's internal reforms, and the country's accession to the World Trade Organisation—is debatable. Yet as Hong Kong and China celebrate the tenth anniversary of their reunion, their self-congratulation seems justified. An experiment without historic precedent, the transfer of Hong Kong's sovereignty while keeping its unique way of life, has come off—so far.

What has not changed in the “Hong Kong Special Administrative Region” (SAR) of China is more obvious than what has. The city streets still hum to the rhythm of commerce. The skyline remains one of the glories of urban ambition. Even the grumbles are unchanged. The harbour—the reason this “barren rock” became a metropolis—continues to shrink as Hong Kong island reverts to the mainland through reclamation.

The red flag of China flutters over Government House, Lord Patten's former home, and government offices are adorned with China's state insignia. But the street names still celebrate former colonial governors—Des Voeux, Robinson, Nathan, Bonham (though, for the foreseeable future, a Patten Boulevard seems unlikely). And servants of the colonial regime still play important roles under the new dispensation. Donald Tsang, Hong Kong's chief executive, the successor to the governor, was formerly a senior member of Lord Patten's administration.

Drastic changes, however, were never likely. The 1997 handover was part of a process rather than a life-changing event. The largest part of Hong Kong's land area, the New Territories, had been Britain's under a 99-year lease granted in 1898. China never recognised that agreement, nor indeed the treaties ceding Hong Kong island and Kowloon in perpetuity. But the expiry of the lease presented practical difficulties, such as over land tenure, so China agreed to negotiations with Britain that led to the two countries' 1984 “Joint Declaration”, confirming Hong Kong's reversion to China at the end of the lease.

Unusually, then, the change of sovereignty was preceded by a long planning period. Unprecedentedly, China also agreed that the transfer would happen on the basis of “one country, two systems”. Until 2047 Hong Kong would keep its own economic and political system and enjoy autonomy in everything except foreign affairs, defence and national security. This was an extraordinary concession for a proud, resurgent nation. It reflected the vision of Deng Xiaoping, who was in the process of opening China up from the autarkic blind alley of Mao Zedong's Cultural Revolution. No Chinese leader since has enjoyed the popularity of Deng in those early years. Many in Hong Kong say that the anniversary the island should be celebrating is not this year's but the one coming up in December next year: the 30th anniversary of the Communist Party plenum that marked the Deng restoration.

The basics 1

Hong Kong's:

Population, 2006	6.9m
GDP per person, 2006	$27,500
Exports, 2006	$316.8bn
Imports, 2006	$334.7bn
Reserves, May 2007	$136.2bn
$ exchange rate, June 18th 2007	7.82
Inflation, April 2007	1.3%

Sources: IMF; Economist Intelligence Unit; Thomson Datastream

Even so, there were reasonable doubts about whether “one country, two systems” could work. The whole point of Hong Kong, both for the people living there and the foreigners doing business with it, was that it was not quite China. It was a place of refugees, “a Chinese colony that happen[ed] to be run by Britain”, according to its historian, Frank Welsh. By 1997 it had become a prosperous, service-oriented economy and a sophisticated, cosmopolitan society. China was a poor agricultural nation in the throes of the world's fastest industrial revolution.

Hong Kong had been a colony with only limited self-rule. But Lord Patten and others like to point to the observation of the late Samuel Finer, a famous historian of government, that Hong Kong's was a unique political system: undemocratic but free. China was, and remains, undemocratic and unfree. Optimism in the late 1980s that its opening-up might include political liberalisation was crushed by the Tiananmen Square massacre in Beijing on June 3rd-4th 1989. For a generation in Hong Kong, that was a defining moment. But 18 years have passed, and for today's bright, otherwise well-informed and sophisticated 17-year-olds mention of it rings only distant bells.

That is not surprising. The biggest challenges Hong Kong has faced in those 17-year-olds' lifetime have stemmed not from Chinese repression but from Asia's 1997 financial crisis, the bursting of the dotcom bubble, and epidemics of bird flu and severe acute respiratory syndrome (SARS). Hong Kong weathered those storms. The economy has just enjoyed its best three years for two decades. As open and free as any in the world, it has proved its flexibility and resilience.

This report will argue that, with some important lapses, China has kept its promises, and “one country, two systems” is working better than many expected. But its continued success is jeopardised by the failure to tackle the big unresolved issue left at the handover: the establishment of an accountable government checked and balanced by a representative legislature. Hong Kong will never sit comfortably in China as long as its politics is a battle between two camps, one labelled “pro-Beijing” and the other “pro-democracy”.

To the relief of Britain and China, Hong Kong has been largely absent from world headlines in the past turbulent decade. But it has not been without its drama. Besides the unforeseen financial and health

crises, there was, in effect, a mass uprising four years ago, in protest at an “anti-subversion law” that China wanted Hong Kong's government to introduce. Seeing their civil liberties threatened, Hong Kong's people took to the streets and won a deferral of the law. Their political freedoms, too, are proving resilient.

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Democracy deferred

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From The Economist print edition

Ten years on, the same old arguments and the same old excuses are trotted out

Get article background

THERE are countless ways to rig an election, some crude, some more sophisticated. But seldom in the history of electoral democracy has so much brainpower been devoted to ensuring that a poll is a foregone conclusion as in Hong Kong over the past three decades. The result is that the people of Hong Kong still do not directly elect by a simple majority either their legislature or the top official in the executive branch, the chief executive.

Donald Tsang, the present incumbent, was “re-elected” in March by an “election committee” of just under 800 people, chosen according to Byzantine rules designed to make certain that the candidate supported by the Chinese government in Beijing will win. Unexpectedly, an opposition candidate, Alan Leong of the Civic Party, secured the necessary nominations from more than 100 committee members to stand against Mr Tsang. So the election was watched with interest, but not suspense: Mr Tsang's victory was never in doubt.

EyePress News

Tsang and Leong: not similar enough

In fact he would have won a fair election. Opinion polls show him enjoying approval ratings of 70% or more. Mr Tsang (or Sir Donald, as he prefers not to be known these days) compares favourably with his predecessor, the SAR's first chief executive, Tung Chee-hwa. Mr Tung had to cope with a series of unforeseen disasters. Even so, his leadership was in most estimations disastrous. China forced him out in 2005 and picked Mr Tsang as his successor.

Mr Tung was a shipping tycoon from a Shanghai family who owed his business's survival to the government in Beijing. Mr Tsang has worked his way up from fairly humble origins and is seen as a local boy made good and a competent administrator. Critics accuse him of being a chameleon. He still sports the bow-ties he wore as a colonial civil servant, but has recently been seen in a Chinese-collared jacket.

Yet Mr Tsang himself has said that the debate about electoral democracy “tortures” Hong Kong. This seems an exaggeration. When, as now, the economy is thriving, the place hardly seems preoccupied with its democratic deficit. But Mr Tsang is right that naturally this is a burning concern for everybody who cares about politics. Increasingly, it also bothers those who want strong executive-led government.

Mr Tsang has promised to resolve the problem during his present term of office, which ends in 2012. According to polls by the Hong Kong Transition Project at the Baptist University, 86% of Hong Kong's people saw him engage in televised debates with Mr Leong and 69% heard him make this promise. That makes it another important reason for his popularity. A government green paper is to be produced later this year, listing three routes to the “ultimate aim” promised in the Basic Law—the mini-constitution for Hong Kong promulgated in 1990—of “universal suffrage” for both Legislative Council (LegCo) and chief-executive elections.

The sooner the argument is settled in favour of representative democracy the better. Since political-party platforms are still defined around when and how “universal suffrage” is to be achieved, the constitutional debate distorts and stunts the development of normal, policy-based political competition. Since LegCo is a mixture of popularly elected delegates and representatives of “functional constituencies” (professional, commercial and other interest groups), its powers—already weak—are attenuated further by questions over its legitimacy. And since Mr Tsang's own popular mandate is even more tenuous, the system is biased towards inaction.

The lack of democracy seems incomprehensible. On the World Bank's figures, Hong Kong in 2005 was the world's tenth-richest country by gross national income per person at purchasing-power parity. One study published this year suggests that its people have the world's highest average net worth (more than $200,000 per person). It is cosmopolitan, modern and open. Its people have proved themselves orderly, moderate and pragmatic—as in their support for Mr Tsang, Beijing's man. They have at times taken to the streets in their hundreds of thousands, but they have done so without violence.

When China agreed in the early 1980s to negotiate with Britain to resume “the exercise of sovereignty” over Hong Kong, its starting-point was that the territory should be handed over intact. Officials sometimes used the analogy of a fragile ornament—“a Ming vase”. A better simile might have been an intricate piece of machinery whose workings no one fully understood. At the time, Hong Kong's administrative and economic system had little in common with the newly reforming one-party rule of Communist China, but it worked well. By then Hong Kong had spent some 140 years as a British colony without enjoying the right to choose its own leaders.

So agitation in Hong Kong for Britain to allow a democratic system was greeted with suspicion. Yet Hong Kong's leaders and legislators had to be chosen somehow, and China stated in the Joint Declaration that the chief executive would be appointed by the central government after elections or consultations held locally. LegCo would “be constituted by elections”. The complex system that was devised allowed some direct elections and some indirect ones, via a carefully selected “election committee” (the mechanism also used to choose the chief executive), and some “functional constituencies”, the majority of which would do what China told them. Those elected to LegCo in 1995, under British rule, were meant to be on a “through train” to Chinese sovereignty.

After the Beijing massacre in 1989 a stronger democratic mandate for future Hong Kong governments seemed even more important. The last British governor, then plain Mr Patten, a Conservative politician rather than, as usual, a senior diplomat, seemed to agree. He tried to squeeze the demands for more representative democracy into the restrictive framework he had inherited.

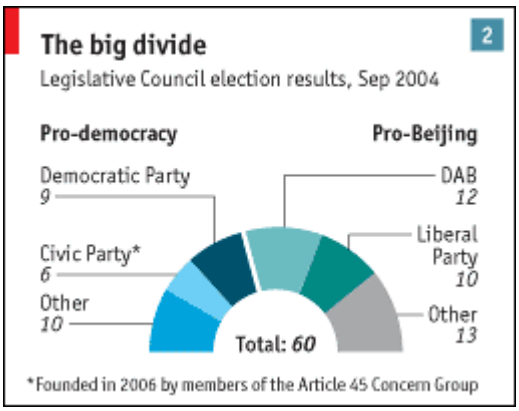
China cried foul, alleging a serious breach of the spirit of the Joint Declaration. But the election went ahead in 1995, and “pro-democracy” candidates trounced the “pro-Beijing” camp. The through train, however, was derailed. Fresh elections under China's rules were held in 1998, and changes in the composition of LegCo resumed “the gradual and orderly progress” promised in the Basic Law. The number of directly elected members rose from 20 in 1998 to 30 in 2004, whereas those picked by the election committee went from ten to nothing. The functional constitutencies remained at 30.

A problem left over from history

In the September 2004 elections “pro-democrats” as usual won about 60% of the votes, despite concerted opposition co-ordinated by mainland-affiliated groups in Hong Kong. This gave them just 25 of the 60 seats. China's “parliament”, the National People's Congress (NPC), the ultimate arbiter of the Basic Law, had already ruled in April 2004 that the time was not right for “universal suffrage” in the LegCo elections in 2008, nor for the chief-executive elections in 2007. The “ultimate aim” is receding into the distant future.

Donald Tsang may be popular, but not nearly as popular as competitive politics. For those seats on the committee to re-elect him where individual voting was allowed in December 2006, pro-democrats triumphed: 114 of 137 candidates who favoured a contested election got in.

Even Jasper Tsang, of the Democratic Alliance for the Betterment and Progress of Hong Kong (DAB), the biggest single party in LegCo, would welcome universal suffrage. The DAB, which developed from the clandestine local communist party of colonial days, is the main grassroots “pro-Beijing” party. Yet Mr Tsang argues real elections could free the DAB of an association that puts off many voters, and allow it to exploit its formidable local network and strength on bread-and-butter issues.



Even if most of Mr Tsang's colleagues agreed with him, which they do not, the DAB would be constrained by what he calls its “20-80” problem. The party's core supporters, he says, are among the 20% of the population who toe the Beijing line, and

would be alienated by any attempt to stray from it. But a cautious proposal for minor electoral reforms ahead of this year's green paper would not win over many of the other 80%.

Much of the time the DAB finds itself in a de facto alliance with another “pro-government” party, the Liberals, dominated by businessmen. Its chairman, James Tien, agrees with Mr Tsang that universal suffrage is unlikely to arrive in 2012. Unlike Mr Tsang, however, he does not think it desirable, regarding it as “too major a change”. The Liberals' biggest proposed reform for 2012 is to give everybody a vote in the chief-executive elections, but to raise the number of nominations a candidate needs to run; this hurdle would then be lowered in 2017 and removed in 2022. As Mr Tien engagingly suggests, voters “could choose between Donald Tsang A, Donald Tsang B and Donald Tsang C”. Others also see the election committee as a useful mechanism for restricting the choice to candidates Beijing supports.

The “pro-democrat” camp is also diverse and divided. Its leading lights range from free-market liberals to left-wing labour activists to the former head of the civil service under Lord Patten and Tung Chee-hwa, Anson Chan. Mrs Chan (“the best civil servant I have ever worked with, by a street”, says Lord Patten) would have made an excellent chief executive. China may have rejected her as somehow tainted by her experience under British rule, and may feel vindicated by her conversion to an explicitly pro-democracy stance. But that conversion has added to her already considerable popularity.

The biggest pro-democracy party, the Democrats, has seen its dominance eroded since the handover. Some of its younger leading lights joined more radical groups. The Civic Party, formed in 2006, has attracted some support, notably from middle-class professionals. Some of the democracy movement's longest-serving leaders have become wearily pessimistic. Martin Lee, founder and former chairman of the Democrats, compares this year's green-paper exercise to an earlier one, in 1987. This was a shameful episode in Britain's late colonial history. Designed to quell enthusiasm for brisker democratisation, it failed to admit the reason: that China would not allow it. Instead it buried the demand for direct elections to LegCo—as the fifth sub-option of the fourth main option in chapter four. “Twenty years completely wasted,” concludes Mr Lee.

Well, not quite. Hong Kong has acquired a more vigorous and vigilant legislature. But Mr Lee recalls that ten years ago nobody was arguing that 2007—the earliest date for the introduction of full democracy allowed under the Basic Law—was too early. Now few expect it even in 2012.

Under the Basic Law, LegCo electoral arrangements after 2007 are for Hong Kong to decide alone, to be notified to Beijing “for the record”. Yet they may be harder to reform than those for the chief-executive elections, which require the NPC's “approval”. The functional constituencies that occupy half of LegCo at present have become powerful vested interests, unlikely to vote themselves out of existence. Already there is talk of their becoming a second chamber to a popularly elected LegCo. Mr Tien, directly elected himself, says the system works better than the sort where legislatures are full of directly elected generalists who become easy prey to professional lobbyists. “We have the lobbyists in parliament,” he explains.

AFP

The people's flag is deepest red

The delay in introducing full democracy is damaging, for several reasons beyond the affront to natural justice. A representative government in Hong Kong would be the best monitor and guarantor of continued autonomy. And, as Mr Lee puts it, the future of the rule of law in the long run depends on popular control of the legislature. But there is also a growing feeling that the present arrangements

simply do not work. The lack of a constitutional link between the legislature on the one hand and the chief executive, his advisory “executive council” (ExCo) and the civil service on the other inhibits both policymaking and implementation. Critics point to the government's inability to reach consensus on issues as diverse as plans for a cultural district in West Kowloon in 2004 and a Goods and Services Tax to diversify its revenue base last year.

Mr Tung tried to tackle the problem in 2002 by filling some of the top civil-service posts with political appointees from business, the professions and academia. Legislators from “like-minded” parties and groups were appointed to ExCo to make it more like a cabinet in a democracy. Mr Tsang now proposes to extend the experiment with a new tier of political appointments to the civil service.

A basic contradiction

Tinkering with the existing structure in this way ignores the basic contradiction: that 60% of the electorate consistently votes for pro-democrats who are not “like-minded”. Yet their candidates are condemned to a minority of LegCo seats and exclusion from these political appointments. This is unlikely to change until the government in Beijing has a rethink, of which there is no sign. The DAB's Mr Tsang thinks that this year's contested chief-executive election will have reinforced its opposition to faster democratisation, despite Donald Tsang's strong popular support.

China had hoped to have him re-elected without a contest. It is still not ready to accept an alternation of ruling parties, fearing that some leading “democrats” are disloyal to China and want to topple Communist rule on the mainland as well. Popularly elected politicians, it reckons, might resort to populist measures (for example, bringing in a minimum wage). The world's biggest Communist party is afraid of democracy in Hong Kong lest it introduce an element of socialism there; and, perhaps, lest it inspire China politically, as it has economically.

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Eternal vigilance

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From The Economist print edition

A respected legal system and a free press are proving competent watchdogs

AP

Get article background

Lai holds the fort

"THE rule of law and a free press": government officials and businessmen repeat the phrase like a mantra that can ward off evil. They are not wrong. An impartial, trusted legal system and the free flow of information remain vital elements of Hong Kong's magic: two essential ways in which it is still not quite China. There were fears for both in 1997; both have survived, if not unscathed.

Worries about the legal system centred on the composition of the Court of Final Appeal (CFA) set up to replace Britain's Privy Council at the apex of the court structure. In fact, even strong critics of the arrangement put in place in 1995, such as Martin Lee, concede that the CFA has proved "very strong". Where the law has looked in trouble it has been because of actual or perceived interference from either the Hong Kong or Chinese governments.

In 1999 the government refused to accept a ruling by the CFA on the rights of abode in Hong Kong of the mainland-born children of Hong Kong parents. It sought an "interpretation" of the relevant passages of the Basic Law from the National People's Congress, which duly overturned the CFA's ruling. On two other occasions the NPC has intervened: in 2004 to rule out universal suffrage in 2007-08; and in 2005 to decree that Donald Tsang's first term as chief executive would last only until 2007.

Nevertheless, the judicial system still enjoys respect at home and abroad. The solicitor-general, Ian Wingfield, is a Briton. He points out that Hong Kong does not even have an extradition treaty with the mainland. And the CFA, closer at hand and less prohibitively expensive to invoke than the Privy Council, has been much better used. Between July 1997 and the end of 2006 it received nearly 800 applications to appeal and nearly 300 substantive appeals, compared with just 103 appeals to the Privy Council in the previous decade.

Some businessmen are worried about a slow chipping away at legal standards. Newer judges, they say, are not of the same calibre as the older ones and may be more susceptible to political pressures. But many leading members of the opposition, such as Mr Lee and Mr Leong, are themselves lawyers, and neither shares that concern. Mr Leong, however, complains about a "lack of commitment to the rule of law", citing examples where "administrative convenience and expediency took precedence".

Whatever the worries about the judicial system, the police force, transformed from a byword for corruption in the 1970s to one of Asia's finest, is deemed to have managed the transition well. One of the 200-odd Britons still serving in the force laments the passing of its "mess culture" and the arrival of a more "autocratic" Chinese management style. But he sees no serious contamination from increased contacts with policemen from the mainland, where corruption is rife.

Keeping spin-doctors away

"I've been wrong," is the rare and refreshing admission of Jimmy Lai, a clothing tycoon turned media mogul, about his pre-1997 gloom. In the 1990s sorrow over the Beijing massacre and trepidation about Hong Kong's future would sometimes reduce him to tears in interviews with the foreign press. Now he finds himself "pleasantly surprised by what has turned out", especially in his own business. "Press freedom exists," he declares.

There is, however, a sting in the tail: "We are the only ones holding the fort." It is true that Mr Lai's

Apple Daily newspaper and his weekly *Next* magazine are among the most outspokenly critical media, and that many other newspapers and their proprietors are, broadly, pro-government and pro-China. The Next group is suffering an advertising boycott from tycoons who do not want to upset China.

There are other, less subtle pressures. In May 2004 three popular radio talk-show hosts resigned, citing political pressure from mainland officials. A Hong Kong journalist, Ching Cheong, is in jail in China as a suspected spy. There are also fears of political motives behind a government-commissioned report this year on public-service broadcasting. It advised against turning Radio Television Hong Kong (RTHK), a government-owned but independent station, into Hong Kong's future public-service broadcaster.

But most journalists concur that a bigger problem than direct pressure is self-censorship. In a survey this year by the Hong Kong Journalists Association, 30% of journalists admitted to censoring themselves and 40% thought their colleagues did. One newspaper journalist recalls an editor's initial rejection of a column by a well-known Taiwanese independence activist. The column was published a week later, after the editor had reconsidered.

In other ways, too, freedom is still there for those who dare to exercise it. Falun Gong, a religious sect banned as subversive on the mainland, continues to proselytise in Hong Kong. And Han Dongfang, a labour activist who was a leading figure in the 1989 Tiananmen protest movement, lives and works there unmolested.

Every June 4th tens of thousands gather in Hong Kong's Victoria Park to commemorate the Beijing massacre. And, as mentioned earlier, on July 1st 2003 hundreds of thousands protested against planned anti-subversion legislation. They forced the government first into three big concessions in the bill and then into its deferral. It still has not been tabled and is “not a priority” for Mr Tsang's administration. Hong Kong knows the price of liberty and, inspiringly, seems prepared to pay it.

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Rather them than us

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Taiwan is not convinced by the Hong Kong experiment

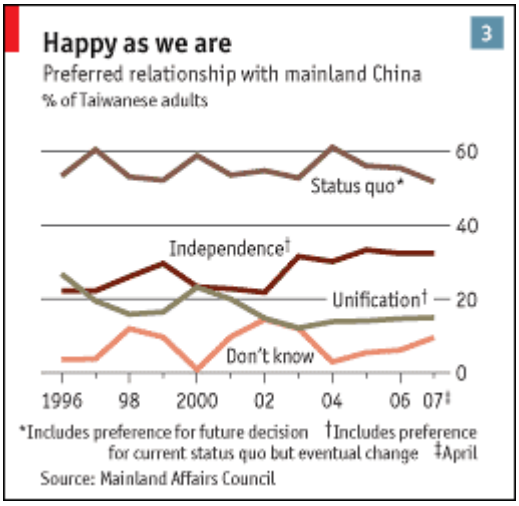
Get article background

HONG KONG is China's third attempt at implementing the idea of “one country, two systems”. Although the language was different, a similar promise—of a high degree of autonomy in everything except foreign affairs and defence—was offered to Tibet in 1951 and Taiwan in 1981. In neither place did it work.

In Tibet the autonomy soon proved illusory. In 1959 Tibetan resentment erupted in a revolt against Chinese rule, soon suppressed. Tibet's spiritual leader, the Dalai Lama, fled into exile with some 100,000 followers. Nowadays he is willing to accept Chinese sovereignty in return for genuine autonomy, but China will barely talk to his representatives.

Taiwan is a different matter. Bringing its 23m people back into the embrace of the “motherland” has always been more important to the Chinese even than reclaiming little Hong Kong from Britain and, in 1999, tiny Macau from Portugal. In 1981 China offered Taiwan even greater freedoms than those later promised to Hong Kong and Macau, including the right to maintain its own army. Taiwan at the time was ruled by the Nationalist Party, the Kuomintang (KMT), dominated by the minority on the island who had fled from China's Communists at the end of the mainland's civil war in 1949. The KMT spurned the offer, maintaining the fiction that it was the legitimate ruler of all of China. With Hong Kong, China had the chance to demonstrate to Taiwan that it could respect autonomy, preserve prosperity and make “two systems” work.

In the meantime Taiwan has become a democracy and the KMT has lost power to the Democratic Progressive Party (DPP), whose leaders lean towards a formal declaration of Taiwanese independence from the mainland. In that, few Taiwanese back them. China has never dropped its threat to “reunify” Taiwan by force if peaceful means fail. But opinion polls show that even fewer Taiwanese favour reunification along the lines of one country, two systems (see chart 3). They see little reason to swap de facto independence for a promise of autonomy, though some are ready to give China credit for keeping most of its promises in Hong Kong.



In Taiwan, as in Hong Kong, political development has been distorted by the relationship with China. The DPP's Chiou I-jen, secretary-general to the president, Chen Shui-bian, suggests that, in time, another similarity may become evident: that partial elections do not work. When Taiwan liberalised in the late 1980s, the opposition had no hope of winning elections because a majority of seats were reserved for delegates notionally representing seats in mainland China. The combination of relatively free elections and predetermined outcomes proved unsustainable in Taiwan, just as democrats hope it will in Hong Kong.

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Light on its feet

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The economy has been blowing hot and cold since the handover, but is now flourishing

Get article background

REALISTS always knew precisely what would follow July 1st 1997: July 2nd 1997. Nor were those who watched financial markets all that surprised when that day brought a sharp devaluation in Thailand's currency, the baht, which had been under speculative attack for some months. But hardly anybody at all predicted that this event would, over the following few months, lead to the most severe regional financial turmoil for decades. Hong Kong, as a regional hub, was inevitably drawn into it. In comparison, the events of July 1st seemed almost irrelevant.

It took some time for the shock-waves from South-East Asia to reach Hong Kong. By the time they did, in 1998, it led to the worst recession in a generation, with GDP contracting by 5.5% that year. Prices fell for five years until modest inflation returned in 2004. A strong recovery in 1999-2000 was stalled by the slowdown in America after the bursting of the dotcom bubble. In late 2001 and early 2002 Hong Kong suffered another recession. Again, recovery was interrupted: this time by the outbreak of SARS in China in 2003, which caused some 300 deaths in Hong Kong and, for a while, crippled the economy.

After three years of recovery, the tenth-anniversary celebrations are held against the more familiar backdrop of thronged shopping malls, packed restaurants and a welter of impressive statistics. The economy grew by 7.5% in 2005 and 6.9% last year. Trade has increased by two-thirds since 1997. More visitors are coming to Hong Kong than ever before—more than 25m a year. It is the world's third-biggest air-cargo hub and second-biggest container port by throughput. Hong Kong continues to top lists of the world's “freest economies”.

That last attribute helps explain the flexibility and impressive strength Hong Kong has shown since 1997 to withstand the battering from so many unforeseen assailants. So, too, does the good shape it was in at the time of the handover, and particularly its extraordinarily strong fiscal position. This was in part a defence against the political uncertainties of the handover, and in part a reflection of China's abiding fear that Britain would empty the safes and cupboards before departing. Although Hong Kong's financial autonomy is guaranteed under the Basic Law, China demanded consultation on the final budget of British rule, prepared by Donald Tsang, the financial secretary at the time.

The all-too-visible hand

The war-chest built up for one campaign proved useful for a different one altogether. In August 1998 the Hong Kong government spent HK$118 billion buying shares on the local stockmarket in response to speculative attacks from hedge funds. Since October 1983 the Hong Kong dollar has been pegged to the US dollar. The peg is backed by a currency board (ie, every Hong Kong dollar is backed by equivalent holdings of US dollars). Attacks on the peg automatically lead to a rise in interest rates, which depresses the stockmarket. So speculators against the HK dollar would also “short” the stockmarket, making money as the market lost value. Because of the peg, the exchange rate remained immune from the contagious devaluations that swept Asia in 1997-98. But the price was paid in five years of deflation and crashing asset prices. Property prices fell by 60-70% from their 1997 peak.

Having intervened in the market—rightly or wrongly—Mr Tsang gained credit for holding his nerve as the scale of the intervention mounted. Alarm about a more active role for the government in the economy turned out to be partly justified. Government officials dropped the rhetoric of non-intervention and adopted slogans such as “proactive market enabler”. But the practical impact of this should not be exaggerated. The government ran fiscal deficits for a number of years from 1998, and expenditure as a percentage of GDP rose as the recession bit. But by 2006 it was back in surplus and its spending ran to only about 17% of GDP, compared with an average for the OECD countries of over 40%.

Even so, critics have accused the government—especially under Mr Tung—of being more partial than its colonial predecessor to three sorts of distorting government activity: picking winners; investing in what should be private-sector projects; and backing favourites. These strands came together in 1999 in the Cyberport project, a property development disguised as an information-technology initiative, negotiated with the Pacific Century Group of Li Ka-shing, the most redoubtable of Hong Kong tycoons. And the decision to put government money into Hong Kong's own Disneyland, which opened in 2005, remains controversial.

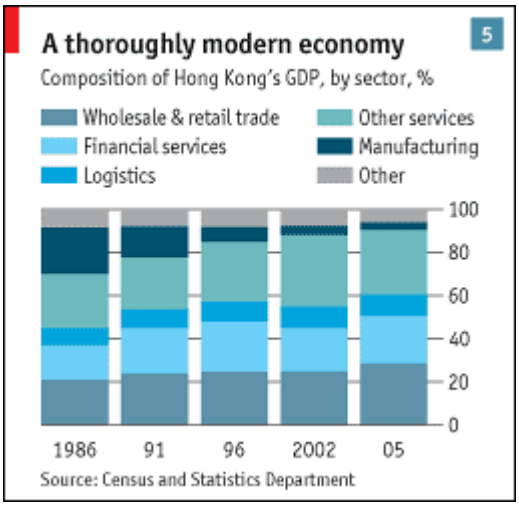
Spending taxpayers' money on such projects lays the government open to attack from critics who say its safety net for the poor remains inadequate, despite an increase in social-welfare spending from 1.6% of GDP in 1997 to 2.4% last year. Such criticism has grown louder in two recessions since 1997. Unemployment before the handover, at about 2% of the workforce, was almost negligible. It climbed to 6.2% in 1999 and 7.9% in 2003. Since then it has fallen every year, but at 4.8% in 2006 was still much higher than pre-handover levels. Over the same period median earnings—about HK$10,000 a month—have not changed at all.

Inequality, as measured by the Gini coefficient, has been rising since 1981 and now compares badly with other developed economies, being roughly on a par with Argentina. The government's financial secretary, Henry Tang, argues that this is a global trend which a small, open economy such as Hong Kong's can hardly resist. Even Alasdair Morrison, former chairman in Asia of Morgan Stanley, a leading investment bank, frets that the ordinary citizen is not getting enough out of Hong Kong's huge success as a global financial centre.

That success is ever more linked to China's soaring economic growth. Hong Kong is still the largest investor in China. Its firms employ an estimated 12m people there. The share of China's trade intermediated by Hong Kong has fallen from about 60% in the 1980s to about 20% now, but the absolute amount has more than doubled since 1996, to $300 billion last year, despite a loss of market share to mainland ports.

Integration with the mainland Chinese economy began in the early 1980s and in many respects has developed independently of the political relationship. Hong Kong remains a separate customs area, with its own fully convertible currency. In the early 1980s Hong Kong still had a manufacturing industry. Rising costs made moving to China an obvious choice.

The transformation of the mainland Chinese economy in the past three decades is well-documented. But on a smaller scale, Hong Kong's own evolution from a low-cost manufacturing base to a hub for services with ever more value added (see chart 5) is almost as remarkable. It has been achieved in symbiosis with the mainland. This gives rise to two common but diametrically opposed prognoses for Hong Kong's economic future.



Pessimists still see Hong Kong as doomed, despite the present rosy outlook. Its fate is now tied inextricably to China's. There are already signs that the mainland economy is overheating. Should it crash, it will drag Hong Kong down with it. But should the mainland boom continue, Hong Kong's importance will steadily diminish compared with other Chinese cities, notably Shanghai. Once China's currency, the yuan, is fully convertible, Hong Kong will be just another Chinese port.

Optimists point to the big helping hand China extended to Hong Kong in the second half of 2003. In the depths of the post-SARS gloom, China came to the rescue in two ways. The "Closer Economic Partnership Arrangement" (CEPA) signed at the time is a free-trade agreement giving Hong Kong firms preferential access to the mainland market. More important, China allowed individual Chinese travellers to visit Hong Kong without joining group tours—a big boost to the local tourist and retail industries. Even if things go badly on the mainland, say the optimists, it will try to spare Hong Kong the worst. And since the city is still integrated into world markets as well as China's, it is somewhat insulated from a downturn in China alone. If Chinese growth continues at its present astonishing rates, however, Hong Kong will continue to

share in the feast.

The truth lies somewhere between these extremes: neither success nor failure is inevitable. Hong Kong is too much part of China's economic region not to be dependent on growth there. And it is likely that Shanghai will take away some of Hong Kong's business. Still, even a declining market share in China can mean huge absolute increases, and Hong Kong is uniquely placed to gain from continued growth in its own backyard.

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Richer than all his tribe

Jun 28th 2007
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The workshop to Hong Kong's front office

Get article background

ONE fear about Hong Kong's future is that the rise of Shanghai might condemn it to becoming the financial hub for “just” the Pearl River Delta (PRD), as Shanghai deals with the booming Yangzi delta region. The worries are premature, such is Hong Kong's lead over Shanghai. But even if they were realised, such a fate might not be the end of Hong Kong.

The PRD is, with the Yangzi delta and the Bohai rim around Beijing and Tianjin in northern China, one of the three most important economic regions of China. The “PRD Economic Zone”, first officially defined in China in 1984, includes the “special economic zones” of Shenzhen, next to Hong Kong, and Zhuhai, bordering Macau, and the neighbouring parts of Guangdong province.

According to a study in 2005 by Michael Enright, Edith Scott and Ka-mun Chang, if the area, including Hong Kong and Macau, were a separate country, it would be the world's 18th-largest economy and its 11th-biggest exporter, ahead of South Korea and India. It has a population of about 65m and the mainland part of it has enjoyed an astonishing average annual rate of economic growth of around 17% for the past quarter-century. Hong Kong firms employ more than 11m people in the region and have provided some two-thirds of the foreign direct investment there. The mainland part of the region has attracted about 22% of all the FDI that has gone into China and accounts for about one-third of its exports and imports. Two-thirds of the world's toys, 45% of its wristwatches and one-third of its consumer electronics, garments and footwear are made there.

No other country in the world has industrialised as rapidly as China; and within China no region has matched the sustained growth of the PRD. To the outside observer it looks hideous: a proliferation of ugly building sites, cramped factories, poisoned waters and filthy smokestacks. Yet there are signs that the region is ready to move upmarket.

Air pollution is now causing a growing clamour and land turns out to have a myriad valuable uses. Wages have gone up, so the number of sweatshops has gone down. K.C. Kwok, the Hong Kong government's economist, says some local governments in the Pearl River Delta are establishing links with officials in Vietnam and Bangladesh to refer potential investors on to them. There is also a “Pan-PRD initiative”, covering the nine southern provinces of China, to help spread development from the congested coast to the poorer inland regions. This, says the Hong Kong government, will position Hong Kong as the hub of a region of 474m people, with a GDP much the same as that of the ten members of the Association of South-East Asian Nations combined. Eat your heart out, Lee Kuan Yew.

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Smog gets in your eyes

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There is doubt about the government's commitment to protecting the environment

Get article background

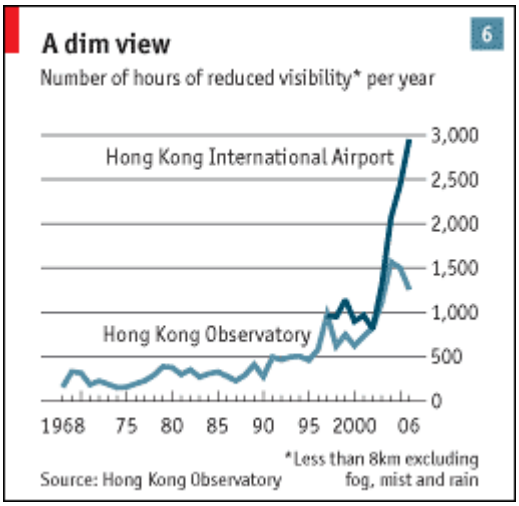
MUCH of the border between the New Territories and China is a stark divide. On one side are tower-blocks and the frenetic building of a modern city; on the other rugged, deserted hillsides interspersed with farmland. Hong Kong's countryside is one of its lesser-known glories. Some 37% of its territory is protected in country parks—a remarkable proportion in one of the world's most densely populated places. The corollary is that most Hong Kongers live in small, high-rise apartments arranged along deep canyons. And their natural environment, they believe, is worsening steadily.

Civic Exchange, a think-tank, sums up a common view in a ten-year review of Hong Kong's environment: “Environmental quality is failing to improve, or even deteriorating in many areas...There is a lack of leadership from the highest level of the government on environmental issues, and a continuing reliance on an infrastructure-led economic model that is exacerbating environmental problems.”

The problem that gets the most attention, and that most shocks returning visitors, is the deterioration of the air quality. This started well before 1997. Civic Exchange cites an estimate based on 1996 statistics which put the additional premature deaths per year resulting from air pollution at 2,000. A commonly used current estimate comes from Anthony Hedley of the University of Hong Kong, who calculates that bad air causes 1,600 deaths a year.

Besides such grim numbers, there are two other reasons why air pollution has become such a huge concern. The first is its visibility—in the form of smog, which has become steadily more common (see chart 6). The magnificent views from those soaring skyscrapers in Hong Kong's Central District are often shrouded in haze. The second is that this is starting to deter people who have a choice from living in Hong Kong.

The air is as bad as in any rich-world city. Sarah Liao, the government's environment secretary, says the sea breeze often used to save Hong Kong from the effects of filling the atmosphere with so many poisons. But now “we have got to the stage where nature says 'no-can-do'...We are swimming in a constant chemical soup.”



A government handout insists that “improving air quality tops the government's agenda”. And Ms Liao gives an impressive list of initiatives, including trying to change individual behaviour. She has been urging building managers to turn up the thermostats on their air-conditioning, and drivers to turn off idling car engines. Now she is contemplating legislation. Emission caps have been imposed on power companies, and Ms Liao says that in the negotiations to set new electricity tariffs from next year, pollution control will be as important as volume generated (almost the sole criterion in the present arrangements). Already, all taxis and half the minibuses have been converted to run on less polluting LPG.

Much pollution, of course, comes from mainland China. The same handout suggests that the Pearl River Delta is the source of roughly four-fifths of the pollution. But another study by Civic Exchange found that last year local emissions were the main cause of pollution on 192 days and mainland emissions on 132. Only 41 days were fairly low on pollution.

Many of the polluting factories on the mainland are owned by Hong Kong businesses. It seems that local authorities in China are getting tougher on the worst offenders. But environmentalists believe that Hong Kong's government is not doing enough to persuade mainland local authorities to help: it is “self-

intimidated”, according to Eric Bohm, who heads the local office of WWF, a conservation body.

Mr Bohm says the government has decided green groups are “anti-development”. Despite its denials, it is also widely believed to see air pollution as an expatriate's concern, at odds with the hunger of local people for growth. And Donald Tsang's “legitimacy deficit” lays him open to the charge that he is more concerned about the interests of the local businessmen who helped to elect him than those of the average breather.

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Life on the margin

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Digital Vision

To secure its future as a world city, Hong Kong needs democracy

Get article background

HAVING grown up to the ticking of a countdown clock, many Hong Kongers have been worrying most of their lives. But Liu Kin-ming, a former head of the Hong Kong Journalists Association, points out that their worries now are the exact mirror image of their fears in 1997. Then the concern was that China would meddle in Hong Kong too much, destroying a cherished way of life and a purringly efficient economy. Now the fear is that Hong Kong will be “marginalised”: that China will not meddle enough.

Nowhere is this feeling more acute than in the financial markets. As financial services have steadily grown in relative economic importance, so has exposure to any fickleness in Beijing's policies. This is particularly true of the stockmarket. Last year the amount of capital raised in initial public offerings (IPOs) in Hong Kong was second only to that in London. Some 73% of the Hong Kong total, or HK$369 billion, was raised by mainland enterprises. By the end of 2006, 367 mainland companies had listed shares in Hong Kong. They account for 55% of the capital raised in Hong Kong in that period and now make up nearly one-third of listed companies, half the stockmarket's capitalisation and 60% of its turnover.

They also help explain the burgeoning operations of the big global investment banks that are competing for a slice of this lucrative market, and their worries that the flow of big mainland IPOs might dry up. There are two concerns. The first is that many of the very biggest deals have already been done. The second is that the Chinese authorities might start forcing more companies to list shares in Shanghai rather than—or as well as—in Hong Kong.

In the short term, some of this is a response to the spectacular bubble on the Shanghai exchange this year. As millions of Chinese citizens have discovered the thrill of gambling on the stockmarket, share prices there have soared. By May, the 40-odd shares listed in both Shanghai and Hong Kong were trading in Hong Kong at an average discount of 43% to those on the mainland. Besides the attractions to share issuers of such high prices in Shanghai, the clear signs that too much cash was chasing too few shares have encouraged regulators to increase the supply of listed companies.

In the longer term, China may indeed want to see Shanghai become a truly global financial centre. Already it is taking steps to improve corporate governance, disclosure and accounting standards. It needs to. According to a ranking of Asian companies in 2005 by the Asian Corporate Governance Association, a private-sector watchdog, China came ninth out of ten, whereas Hong Kong came second, behind Singapore. Nevertheless, Goldman Sachs, in an assessment of Hong Kong Exchanges, the listed company running the stockmarket, fretted about the perception of its “eroding pre-eminence” compared with Shanghai. But Paul Chow, chief executive of Hong Kong Exchanges, says that “battle has not started” because the yuan is not fully convertible.

Open for business

Mr Chow may well be right that Hong Kong need not worry yet. It is so far ahead of Shanghai in terms of institutions, laws, connections and English-speakers that catching up will take decades. As China's prime minister, Wen Jiabao, put it himself this year, “Hong Kong's position as a financial centre, shipping centre and trade centre is irreplaceable.”

Even if the IPO bonanza were to peter out, there would be other opportunities. For example, China says it wants to invest $300 billion of its foreign-exchange reserves. And if China were to open up further and liberalise its exchange rate, Hong Kong would benefit so much that a loss of market share might be almost irrelevant.

The same factors that make Hong Kong an appealing Asian foothold for financial institutions attract other businesses too. Hong Kong still has 6,300 offices of Chinese and foreign companies. Nearly 4,000 of these are “regional headquarters”, drawn not just by Hong Kong's reliable legal system and free flow of information but by its efficient, well-connected airport. It is hard, for example, to cover Taiwan, the world's 16th-largest exporter and importer, out of mainland China, because there are no direct scheduled flights.

However, there are signs that Hong Kong is becoming less appealing as a base for Westerners. Estimates from Hong Kong's immigration department of the number of Western expatriates fell by about one-third between 2001 and last year, to just over 70,000. Among the factors blamed are air pollution, a shortage of places in international schools and the sky-high price of top-quality accommodation. But the growing role of China in the local economy, generating more jobs that can be filled by local people, may also have something to do with it. And some Western expatriates who have stayed say that far more of them are buying property and investing in Hong Kong for the long term than before 1997.

It is certainly not that foreigners are fleeing because the darkest forebodings have come true and China has made Hong Kong a bad place to do business. When the Chinese government has intervened directly in Hong Kong's business affairs, it has met with vigorous opposition. Last year, for example, there was a row over Hong Kong's largest telecoms firm, PCCW, whose chairman and main shareholder, Richard Li (Li Ka-shing's son), tried to sell the firm's main assets to a foreign consortium. The deal began to crumble when a Chinese firm, China Netcom, which owned 20% of PCCW, objected to the sale. An agreement reached when China Netcom acquired its stake in PCCW in 2005 had in effect given it a veto over any large share sales. The company was reported to have been acting under instruction from Liao Hui, the head of China's Hong Kong and Macau Affairs Office. China is not alone in discriminating against foreign would-be purchasers of strategic assets. Its own attempted takeover of Unocal, a Californian oil firm, in 2005 was scuppered by American concerns about ceding ownership to China. Even so, the affair was a serious breach of Hong Kong's commercial autonomy.

Such incidents, despite dire warnings, have not so far done any fundamental damage to Hong Kong. Even before the handover, China's commercial clout was felt in the influence of its big enterprises in Hong Kong and the belief of both Hong Kong and foreign businesses that it made sense to cultivate them. Those businessmen that displeased China, such as Jardine's bosses (see article), or Jimmy Lai, who was hounded out of his successful clothing chain, Giordano, suffered the short-term consequences.

Yet in most respects China has honoured the promise of “Hong Kong people ruling Hong Kong” with a high degree of autonomy. The exception, however, makes a mockery of the other promises: Hong Kong's continued inability to choose its own political representatives and leaders. China utterly refuses to yield that kind of autonomy to Hong Kong; indeed it is prepared to intervene egregiously in Hong Kong's affairs through its support for the candidates it favours in Hong Kong's “partial” elections and through its “interpretations” of the Basic Law to make sure those elections remain partial. The response from the present Hong Kong government mimics the “pre-emptive cringe” of pre-Patten British colonial regimes. Rather than stand up for the rights of Hong Kong's people, it is inclined to second-guess the views of the government in Beijing.

Asia's world city

Such a puppet government will find it hard to deliver decisive leadership, and will remain vulnerable to attacks on its legitimacy. With their big demonstration on July 1st 2003, Hong Kong's people not only achieved the indefinite delay of an objectionable piece of legislation; they also, in effect, brought down the government of Tung Chee-hwa. But the conclusion the Chinese government seems to have drawn from the episode is depressing: that full democracy should be deferred further, perhaps for ever. That may be unwise. According to Lord Patten, Hong Kong is a moderate place and no threat to China, but “if

there is one thing that could make Hong Kong immoderate, it is blocking attempts to introduce more accountability into the political system.”

At times in Hong Kong's recent history its political system has been a matter of global interest: at the time of the Joint Declaration in 1984; after the massacre in Beijing in 1989; and in the years around the handover in 1997. Ten years on China has managed to make Hong Kong's political demands seem an almost parochial concern. Britain's Foreign Office produces a restrained six-monthly report on the territory, and American politicians occasionally raise the issue with China. But nobody pretends that foreign governments have much leverage.

China clearly has an interest in Hong Kong's success, but cares even more about its stability. That is especially true as China readies itself for the 2008 Olympics, to be held in Beijing—except for the equestrian events, which will be staged in Hong Kong because of the prevalence of equine diseases in Beijing and other mainland cities. Is this a metaphor for what Hong Kong has become: a useful adjunct to the mainland, with better quarantine arrangements?

It is still much more than that; still, in the slogan trumpeted by its government, “Asia's world city”. Hong Kong remains China's pre-eminent international city, competing with London and New York as much as with Shanghai and Singapore. The biggest risk to this status remains China's bizarre idea that it can be an “economic” city without being a “political” one. And its best defence remains the extraordinary resourcefulness, common sense and vigilance of its people.

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A tale of two hongs

Jun 28th 2007
From The Economist print edition

And two ways of handling a handover

Corbis

When Jardine was a baby

Get article background

THE rivalry between the old colonial trading houses—the hongs—that used to dominate business in Hong Kong is the stuff of legend. As Hong Kong's reversion to China loomed, two of the crustiest adopted opposite strategies. Jardine Matheson, founded in 1832 and still commemorated in a number of Hong Kong place names, confronted the Chinese authorities and became, say its bosses, a “whipping boy to beat up the British”. In contrast, Swire, heir to Butterfield & Swire, in business in China since 1861, seemed eager to please. In 1996 it sold 25% of Cathay Pacific, Hong Kong's “flag-carrier” airline—to CITIC, a Chinese investment firm, and other mainland investors.

Jardine's fall into disfavour followed its decision in 1984 to shift its legal domicile to Bermuda, and then, a decade later, to delist its shares from the Hong Kong market. Both moves dented commercial confidence at sensitive moments. It did not help when Henry Keswick, Jardine's chairman, told a British parliamentary committee in 1989 that Britain was handing Hong Kong over to a “Marxist-Leninist, thuggish, oppressive regime”. Chinese polemicists have long historical memories and linked the fleet-footedness and insults to Jardine's role in the 19th-century opium trade.

Chinese pique was such that, for much of the 1990s, it would have no truck with Jardine. But ten years on, Mr Keswick says, “business has never thrived better.” There is no “post-colonial kickback”. The group remains Hong Kong's biggest employer outside the government. In the past ten years its shares have shown a compound annual growth rate of 21.3%. One subsidiary, Hongkong Land, owns much of the territory's best office space. Others are big in construction, engineering and supermarkets. One-quarter of its revenues derive from Hong Kong and China, and most of the rest from South-East Asia. This, says Mr Keswick, is one of Hong Kong's wonders often overlooked in the euphoria about China: it is the centre of an overseas Chinese commercial diaspora spanning the region.

As Jardine has found before, however, Chinese leaders bear long grudges. Despite the present boom, it may be too early to celebrate reconciliation. And if Jardine can claim vindication for its strategy, so can Swire. It is similarly diversified. But an airline deal it struck last year symbolises the interlocking business interests of Hong Kong and China. Swire gained 100% ownership of Dragonair, a mainly domestic Chinese airline, and doubled its shareholding in Air China, the national flag-carrier, to 20%. Swire and CITIC both reduced their holdings in Cathay and Air China bought 17.5% of it. The arrangement prompted some to ask, as they do of Hong Kong and China, “who took over whom?”

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Pharmaceuticals

Beyond the blockbuster

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Getty Images

Drugs firms are rethinking their business model

Get article background

LIPITOR is a drugs company's dream. The cholesterol pill made by Pfizer, an American pharmaceuticals giant, is the world's best-selling drug. Last year it earned over $13 billion in revenues. Other hugely successful drugs include GlaxoSmithKline's Advair, an asthma remedy, and Plavix, a blood thinner, which is sold by Bristol-Myers Squibb and Sanofi-Aventis. Both enjoy billions of dollars in annual sales. Despite such rewards, however, pharmaceutical companies are reconsidering their pursuit of blockbuster drugs, as new technology permits the creation of niche remedies that target rare ailments or sub-populations of people suffering from common diseases.

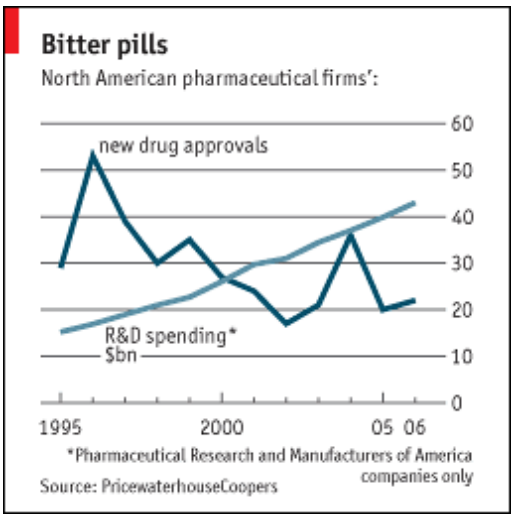
That explains the $3 billion hostile takeover bid announced this week by Roche, a Swiss pharmaceutical firm, for Ventana Medical Systems, an American diagnostics firm. This year, Roche has gobbled up several diagnostics and genetic-testing firms making technologies that enhance the value of its targeted cancer therapies. The firm recently completed a $155m takeover of 454 Life Sciences, which makes gene-sequencing technology and last week spent some $273m on NimbleGen, which makes technologies used in identifying the genetic causes of disease.

Roche is being drawn away from conventional one-size-fits-all drugs partly by the allure of the lucrative new markets being created by the development of “personalised medicine”. But drugs giants are also victims of their own success. Blockbusters like Lipitor are already so effective, argues Tom Nagle of Monitor, a management consultancy, that it is difficult to come up with alternatives that are good enough to command a higher price.

Worse, many blockbusters are going off patent soon and pharmaceutical giants are finding it increasingly difficult to come up with new drugs to replace them—despite throwing pots of money at the problem (see chart). Makers of generic drugs are also growing more assertive in attacking patents. As a result of all this, reckons IMS, an industry consultancy, the industry saw a record $18 billion in branded sales collapse in 2006.

There are signs that long-term investors are growing concerned. A coalition of institutional investors representing over $1.1 trillion in assets, issued a report this month demanding a “rethink of core business assumptions”. Martin Eijgenhuijsen of ABP, a Dutch pension fund that is part of the coalition, says, “We have serious doubts that the current business model can deliver targeted drugs.

This requires radical change.”



So is the industry ready to follow Roche's lead toward specialty products, targeted therapies and the like? The answer seems to be yes. Ray Hill of IMS calculates that although the vast mainstream market for chronic diseases like high blood pressure or diabetes is still important, specialty drugs accounted for nearly two thirds of total revenue growth last year, up from just a third in 2000. And only a quarter of drugs launched last year tackled chronic diseases, suggesting the pipeline is shifting toward targeted therapies.

For that trend, thank both technology and regulation. Anthony Farino of the consultancy arm of PricewaterhouseCoopers argues that such technologies as high-throughput sequencing, genomics and personal phenotyping, which were not available five years ago, are now transforming how drugs are discovered and tested. Ron Krall, GSK's chief medical officer, thinks the trick is identifying which patients will benefit most from new treatments—or, equally usefully, which ones will have adverse reactions. To determine that, his firm has just opened a new facility in London run jointly with Imperial College and Hammersmith Hospital, where experimental drugs are tested. The “micro-doses” they administer to patients are analysed in real time by molecular scanners.

Regulators could play a decisive role in the large drugs companies' shifting strategies. The risk-averse stance they have taken since safety problems led Merck to recall its painkiller, Vioxx, may help propel the industry more rapidly away from blockbusters. Viren Mehta, an industry expert, speculates that although new drugs will always carry unknown risks, the regulatory burden might prove lighter for those aimed at specific, acute conditions (as opposed to ongoing maladies like diabetes). After all, he says, “Fewer people are at risk for a shorter time.”

Another regulatory boost may come from cost-benefit analysis that considers the long-term benefits, and not just the high price tags, of innovative new drugs. Britain's National Institute for Health and Clinical Excellence (NICE) has approved Herceptin, a targeted cancer drug, despite an annual cost per patient of nearly $50,000 because, in the words of Sir Michael Rawlins, NICE's chairman, “it provides long-term value”. NICE has also agreed to buy a cancer treatment made by Johnson & Johnson that has little effect on a third of patients, on the condition that it pay only when the drug works. And with an expensive Alzheimer's drug, the agency ruled that it would not pay for patients with the mildest form of dementia to take it—a ruling that was challenged in a London court this week.

Such lawsuits are a sign that the transition to a new way of doing business carries risks. But as Graham Higson, head of regulatory affairs at AstraZeneca, a British drugs firm, notes: “There's no such thing as no risk. The industry simply cannot continue developing drugs exactly the same way it has for 40 years.”

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Internet radio

Tuning out

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A battle over music royalties threatens a nascent industry

STEREO HITS, a radio station in Cobán, Guatemala, decided to go global last year. In an effort to boost revenue from its advertisers, which include Coca-Cola, Panasonic and PepsiCo, it began streaming its broadcasts over the internet, allowing anyone in the world with a connection to tune in. Raúl Najera Ponce, head of the station's online unit, estimates that this "webcasting" costs Stereo Hits just $100 a month, since it needs neither a frequency licence nor a transmission tower.

Mr Najera Ponce also keeps costs down by neglecting to pay royalties on copyrighted music. In theory, specialist agencies should collect fees for every song that radio stations play and distribute them to the owners of the copyrights. The result is a complicated web of contracts and payments among radio stations, collection agencies, record labels, composers, musicians and their estates. But Mr Najera Ponce chose a simpler way to remunerate musicians and labels. "If we need music from a band in London, we buy their disc—that's how we collaborate," he says.

Collection agencies and the record labels they represent have long struggled to extract royalties from radio stations. The International Federation of the Phonographic Industry (IFPI), an industry group, estimates that half of Russia's radio stations fail to pay royalties, for example. But internet radio stations are even harder to corral, because they are smaller, more numerous and tend to be run by hobbyists who find it too complicated and expensive to pay their dues. IFPI estimates that just 10% of Russia's webcasters cough up.

Almost all of America's 14,000 or so webcast stations, which have 34m regular listeners and income from advertising, do pay royalties. Nonetheless, for several reasons America is where the big record labels and SoundExchange, the collection agency representing them, are fighting hardest to bring in more money. For one thing, America's traditional radio stations pay relatively little in royalties, thanks to a 1909 law that mandates fees for composers but not for performers. (Low royalties, radio stations have argued, are justified because playing songs provides performers with free publicity.) The frustrated record labels are anxious to establish a less generous system for webcasters. Moreover, America's strong legal system should make it easier to enforce their rights.

In March the record labels persuaded America's Copyright Royalty Board (CRB) to triple royalties for webcasters, to roughly a fifth of a cent per-song per-listener, with retroactive effect from the beginning of 2006. This will almost certainly put most webcasters out of business. They will also have to pay SoundExchange $500 for each channel they stream when the ruling takes effect on July 15th. This fee is likely to eliminate one of the most cherished features of online radio: the customised channels that listeners can concoct using software that produces playlists based on the names of favourite bands or songs. One popular webcaster, Pandora, creates customised channels for some 7m users. It cannot possibly afford to pay $500 for each one.

Outraged internet-radio fans have sent more than 400,000 e-mails, faxes and letters of protest to America's congressmen. In response, several of them drafted a bill called the Internet Radio Equality Act in the House of Representatives in late April. If voted into law, it will nullify the CRB's decision. On June 26th many American webcasters stopped broadcasting for a day and posted messages on their websites urging disappointed listeners to lobby Congress on their behalf. The two sides are also doing battle in the courts.

The quest for higher royalties may actually be doing record labels more harm than good. People generally do not buy music unless they have already heard it. Internet radio makes it easy to zero in on a preferred genre, so listeners are more likely to discover music they would want to buy. Many online stations even provide links to online music stores—free of charge.

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French newspapers

The rag trade

Jun 28th 2007
From The Economist print edition

Bernard Arnault tries to sell one publication and buy another

ANYONE hoping to read a French business newspaper on June 25th would have struggled to find one. Neither of the two most popular publications, *Les Echos* and *La Tribune*, appeared that day, after staff at both decided to strike. Both protests aimed to influence Bernard Arnault, a luxury-goods tycoon who is France's richest man—but to very different ends. Employees at *La Tribune* do not want Mr Arnault, who owns the paper, to sell it, for fear that they might lose their jobs. Journalists at *Les Echos*, meanwhile, do not want Mr Arnault's group, Moët Hennessy Louis Vuitton (LVMH), to buy the paper, for fear that he might meddle in its coverage.

Mr Arnault has lost patience with *La Tribune*, which has turned a profit in only two of the 13 years he has owned it. He has asked bankers at Lazard, an investment bank, to find a buyer for the paper. But he has not given up on newspapers altogether. He is in talks with Pearson, a media group (and part-owner of *The Economist*), about a takeover of *Les Echos*, which does make money.

Mr Arnault's plans have caused a storm. More than 200 of the great and the good, including Ségolène Royal, the Socialist Party's candidate in France's recent presidential election, and Jean-Claude Juncker, the prime minister of Luxembourg, signed a petition to decry the prospective purchase of *Les Echos*, which will celebrate its 100th birthday next year and is something of a national institution. After all, critics point out, editors at *La Tribune* have repeatedly denounced Mr Arnault for attempting to interfere with its coverage.

Business, politics and the media have become hopelessly intertwined in France in recent years. By some calculations almost three-quarters of the print media is controlled by Dassault, a defence company, and Lagardère, a media and defence group. Bouygues, a construction and telecoms group, controls TF1, a television channel. Martin Bouygues, the boss of Bouygues, and Arnaud Lagardère, boss of Lagardère, are close friends of Nicolas Sarkozy, the new French president. So is Mr Arnault, who was a witness at Mr Sarkozy's wedding. The mistrusting journalists of *Les Echos* fret that Mr Arnault will try to use the paper to bolster his position at the heart of this chummy network.

Pearson promised to sell *Les Echos* only on the condition that a buyer offer some guarantee of editorial independence—just the sticking point that until this week was holding up News Corporation's bid to buy Dow Jones, which publishes the *Wall Street Journal*.

Yet Antoine Boudet, the representative of *Les Echos* at France's main journalists' union, thinks that Pearson will not be too punctilious about such principles. Mr Arnault is offering €250m ($336m) for *Les Echos*—25 times the paper's operating profit last year. This is about €80m-100m more than most analysts think the paper is worth. Moreover, if *Les Echos* were to lose its reputation for authoritative reporting under new ownership, Pearson might win new readers for the *Financial Times*, its main publication.

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Tourism in Asia

After the deluge

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Credit-card data show how tourists respond to disasters

AP

Forgotten within a year

SUFFERING from a tsunami or terrorist attack comes in stages. First are the casualties—the people killed and injured, and the lives that are shattered; then comes the less dramatic but still devastating damage to surviving businesses which can pile hardship on trauma.

Measuring the economic aftershocks is hard. But Visa, a credit-card firm, has found a rough guide, by tracking foreign visitors' spending in several Asian destinations hit by disasters of one kind or another in the past five years.

Not surprisingly, tourists are a fickle bunch. Their rapid reaction to bad news is reflected by fast and dramatic cuts in spending. But tourists also appear to have short memories. Visa's data suggest a noticeable recovery can come within a year—although the figures vary and terrorism seems to have more of a dampening effect than natural disasters do.

Bali was hit twice by bombings, in 2002 and 2005; each incident was followed by a sharp decline and a slow rebound. Growth took about a year to resume, but spending has yet to surpass its 2005 peak.

In Sri Lanka a four-year lull in a long-running civil war led to strong growth in tourism. A flare-up in June 2006 cut out most of the growth; subsequent fighting and bombings have caused spending to fall even as it has begun to rise strongly in the nearby Maldives.

But to see how strongly a stricken region can rebound, consider the experience of the Thai island of Phuket, which was hit by the tsunami of December 26th 2004. The damage has been repaired and tourists seem to have abandoned their misgivings—encouraged, perhaps, by a clever marketing campaign. The recovery was obvious by 2006. This year spending has set records.

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Doing business in Russia

A settling of accounts

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Two Western firms get on better terms with the Kremlin

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GOOD news for the Kremlin: no longer must it work so hard to justify the destruction of Yukos, a bankrupt oil firm, or defend the predatory instincts of Gazprom, its gas giant. It is finding surprising support from large foreign companies. On June 24th PricewaterhouseCoopers (PWC), an accounting firm, said it had withdrawn a decade's worth of audit reports for Yukos, thus bolstering the case against a company that the Kremlin would like to portray as Russia's Enron. And last week BP agreed to assist state-controlled Gazprom in its quest to expand overseas, despite a long-running dispute. The process has been “very educational”, BP's Russian partner quipped.

TNK-BP, BP's Russian joint venture, owned a majority stake in the Kovykta gas field, but could not meet production quotas stipulated by its licence mainly because Gazprom refused to develop an export pipeline. TNK-BP stood to lose both the licence and its investment. But surprisingly, instead of waiting for TNK-BP's licence to be revoked, Gazprom agreed to buy TNK-BP's stake for about $800m (less than a third of its real value, say some analysts).

In addition, Gazprom gave TNK-BP an option to buy back 25% of the field at a market price, but only if BP fulfils its part of the deal. The reason for such “generosity” is BP's agreement to form a strategic alliance and swap assets with Gazprom. That could help it enter countries where it is mistrusted. “The Kremlin tried a direct approach to European markets, but was rebuffed. It now has strong local partners, who will do the running,” says Christopher Weafer, chief strategist at Alfa Bank.

Cutting deals with whimsical governments is par for the course for oil companies. But the withdrawal of an audit, let alone a decade's worth of them, is a rarity. Like anybody connected with Yukos, PWC had been under enormous pressure.

The Kremlin found PWC's failure to unearth any flaws in Yukos's accounts irksome. The authorities raided its offices and accused it of tax evasion and of collusion with the former management of Yukos to conceal profits. It risked the loss of its licence and began to lose lucrative contracts.

“This case challenges the basic role of the auditor, which represents a key element in the development of a normal, functioning economy,” Mike Kubena, the firm's managing partner in central and eastern Europe, argued only six months ago. Now he stoutly maintains that PWC revised its opinion not because of the threats, but in the light of new information—although he will not say what that information is, only that it came from Russian prosecutors, who hailed PWC's decision. The change will strengthen the case against Mikhail Khodorkovsky, an ostracised oligarch and former boss of Yukos, who may now stay in prison well beyond his present eight-year sentence.

PWC now argues that Yukos's managers must have lied about related-party transactions via trading companies. But Bruce Misamore, the former chief financial officer at Yukos, denies this. “PWC was fully informed and knew more about the structure of the company than some of the most senior managers,” he says. PWC stands to renew a lucrative contract with Gazprom and may win its appeal against tax-evasion charges.

PWC's *volte-face* seems unlikely to hurt it elsewhere in the world because of its federated structure: Mr Kubena says that the decision to withdraw the audits was the Russian firm's and entirely appropriate given the new information. Any controversy is likely to be discounted by outside observers as an unfortunate fact of Russian life, particularly where Yukos is concerned. “I doubt events in Russia would have any effect on perceptions of PWC in America,” says Mark Cheffers, boss of Audit Analytics, a research firm. Instead, the likeliest victim of the saga is that normal, functioning economy of which Mr Kubena used to speak.

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Shareholder activism in Japan

In the locust position

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Investors are pushing Japanese firms to increase shareholder value

IT IS the season for shareholder meetings in Japan. The majority of publicly traded firms held their annual meetings this week—around 1,000 of them on June 28th. The practice was originally intended to make life difficult for *sokaiya*, racketeers who dish dirt at the meetings of firms that do not pay them off. This year, however, Japanese managers faced an even more menacing threat: activist shareholders.

Corporate law is actually more shareholder-friendly in Japan than in America or Britain. In theory, Japanese shareholders can vote directly on dividends and executive pay. They can even oust the entire board without cause. In practice, most Japanese investors defer to managers.

However, foreigners now own 28% of Japanese firms' shares. They have called on managers to use large cash reserves to increase dividends or buy back shares. Around 30 companies faced shareholder resolutions this year, almost twice last year's figure. Activists have also demanded revisions to articles of incorporation and the unwinding of recently established “poison pill” measures aimed at preventing hostile takeovers.

The assertiveness has sent shivers through staid Japanese boardrooms. Managers fear they might lose control over boards and find their authority checked. Politicians and media demonise the activists as financial criminals who prize short-term gains over firms' long-term health.

Elsewhere activist shareholders have got firms to jettison assets or cut managers' pay. A senior German politician famously called them “locusts” in 2005. But in Japan, they are upending the tight-knit business culture to an even greater extent. This is because they are exposing many practices, such as the maintenance of large cash reserves, a reluctance to sack staff and close relationships with suppliers, buyers and creditors. Although these were responsible for Japan's post-war success, they are now seen as holding its firms back.

After years of policy reforms and corporate restructuring that helped turn around the economy, Japanese companies have little debt and are making record profits. But strong operational management has exposed poor financial practices. Despite their hoards of cash, many firms offer shareholders meagre returns. The cash and securities held by Japanese firms is equal to 16% of GDP; in America the long-term average is around 5%. And Japanese companies' return on equity is around 9%, compared with between 14% and 17% in America and Europe.

This suggests that Japanese managers could put their profits to better use, perhaps by returning more money to shareholders who could then invest it more productively. Many listed companies have book values greater than their stockmarket values—which tends to send financial sharks into a feeding frenzy.

Steel Partners, based in America, has investments worth $4 billion in some 30 Japanese companies, including Sapporo, a brewer. At recent shareholder meetings, three companies passed poison-pill provisions to block Steel from buying controlling stakes. One such measure, adopted by Bull-Dog Sauce, in effect diluted Steel's 10% stake to around 3%.

After the meeting, the president's eyes grew moist as she described how the 105-year-old condiment maker had felt it must take such action if it was to ensure its survival. This week a court ruled the dilution was acceptable, in what is seen as a test case on the legality of poison pills. Nearly 400 firms have gone ahead with such provisions since May. Other activist funds facing resistance include Ichigo Asset Management, The Children's Investment Fund (TCI) and Dalton Investments.

And yet Japanese investors are also beginning to show an activist streak, helping to legitimise the foreigners' objectives if not their tactics. Although one of the earliest and most prominent activists, Yoshiaki Murakami, has been felled by charges of insider trading, others are stepping into the breach.

Japan's Pension Fund Association, a quasi-governmental body that oversees more than $100 billion of assets, recently said that it will insist on higher dividends and vote against the directors of firms that have had a return on equity of less than 8% for three consecutive years.

Meanwhile Sparx Group, a publicly traded investment fund, is quietly working with managers to identify mergers that benefit shareholders. It recently brought together Japan's oldest camera firm, Pentax, with Hoya, a maker of glass lenses.

Japanese bosses gripe about activism, yet privately concede that the pressure is spurring many firms to increase returns to shareholders. If nothing else, shareholder meetings are getting longer. In previous years they lasted around 30 minutes—just enough time for the ink to dry on the directors' rubber stamps. Those days are becoming as anachronistic as the *sokaiya*.

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Face value

A new broom

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From The Economist print edition

Cynthia Carroll hopes to extract greater riches from the dusty terrain of Anglo American

THE world of mining is in flux. Most firms in the business are flush with cash, thanks to high metals prices, and are buying one another up with gay abandon. Upstarts from Russia and Brazil are challenging more established Western rivals. Even the biggest firms are said to be plausible targets for takeovers.

The world of Cynthia Carroll is in flux too. In January she moved from Montreal to London, to become boss of Anglo American, the world's second-biggest mining conglomerate. Her husband and four children are waiting until the end of the Canadian school year to join her in London. Meanwhile, she has spent much of the past six months on planes, touring Anglo's operations around the world, peering into shafts and smelters, and chatting to managers and minions alike.

Anglo American is not used to such turmoil. Mrs Carroll, an American, is the first non-South African to head the firm. She is also the first external candidate (her previous job was at Alcan, a big Canadian aluminium firm). Her predecessor at Anglo, Tony Trahar, had spent 33 years at the firm. When she was appointed, Sir Mark Moody-Stuart, who chairs Anglo American's board of directors, explained that the new boss should be someone who could lead a change of culture at the firm. So Mrs Carroll, in other words, is supposed to breathe some fresh air into the $87 billion mammoth, whose reputation is rather staid, male, and much more old-school Anglo than cutting-edge American.

To be fair, that reputation is a little out of date. The 90-year-old Anglo American has branched out far and wide from its South African roots. It now employs 190,000 people in 65 countries. In 2005 the group decided to focus on mining, and embarked on an ambitious restructuring, which was well under way by the time Mrs Carroll took the reins. Mondi, its paper and packaging business, is being demerged and is due to list in London and Johannesburg on July 3rd. Anglo American has also shed its underperforming steel business and plans to sell its remaining stake in AngloGold Ashanti, since investors value free-standing gold-mining operations more highly than those that are part of conglomerates. All this has helped improve Anglo's margins and returns—and its share price, which outperformed its competitors' last year.

But there is plenty more to do. Anglo's two main rivals, BHP Billiton and Rio Tinto, seem to offer better margins and returns. Daniel Fairclough of Merrill Lynch points out that the pair are the products of block-busting (and cost-cutting) mergers—the sort of upheaval that Anglo American has never undergone.

Can Mrs Carroll burnish the firm's performance? She is no miner, but speaks the language thanks to a degree in geology. She has spent her career in similar industries, first at Amoco, an oil company, and then at Alcan, where she ran the core metal-making business. Under her supervision, its productivity

improved dramatically. She also presided over the successful integration of a rival firm, Pechiney, into Alcan, reaping large savings.

Shopping and saving

Mrs Carroll would like to make acquisitions at Anglo too. In fact, the firm has already started shopping. So far this year, it has bought a share in an iron-ore project in Brazil and the Michiquillay copper deposit in Peru. It will also be growing organically, with $7 billion of new projects already approved, and another $10 billion to 15 billion under consideration.

The new boss also hopes to bring her knack for improving productivity to bear. She has already started thinning out layers of management and cutting red tape. She wants Anglo's many divisions to pool functions such as procurement so as to create economies of scale and to share practices that might cut costs or improve output. She promises to encourage innovation, to set ambitious targets, especially on safety, over which Anglo has suffered some recent lapses, and to judge managers by their performance. Such shared standards, she hopes, might imbue the firm with a sense of common purpose.

A new face might also help with public relations. Mrs Carroll admits that the firm's relations with the South African government have been prickly in the past. When Mr Trahar implied in an interview a few years ago that South Africa still carried a degree of political risk, President Thabo Mbeki was outraged. The authorities have berated the firm's platinum unit for its slow progress in meeting targets on black economic empowerment, a process meant to redress the economic injustices of apartheid. As a result, the government has not yet granted it the permits it needs to keep mining after 2009.

Mrs Carroll says she intends to improve ties with governments, as well as customers, suppliers and local communities. “I think we're a very good partner,” she says, mentioning the group's initiatives on HIV/AIDS and efforts to help small entrepreneurs in Africa. She co-chaired this year's World Economic Forum on Africa earlier this month, rubbing shoulders with politicians and businesspeople from around the region. “We've learnt to engage with governments in a constructive and co-operative way.”

All these changes are needed if Anglo American is to get on top of its game—and out of its competitors' reach. Rumour persistently paints the firm as the object of an imminent takeover bid, although nothing tangible has materialised so far. But as long as Anglo American is thought to be underperforming its potential, it is at risk.

The firm's employees must be conscious of the threat. At any rate, Mrs Carroll says they are hungry for change and have welcomed her, despite the turmoil she brings. She could not have dreamt of a better reception, she says. “We came together at the right time.”

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East Asian economies

Gold from the storm

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From The Economist print edition

Ten years after Asia's financial crisis, the region is booming again. Has it fully recovered or are economic mistakes being repeated?

Reuters

IT IS an unhappy anniversary: July 2nd 1997, the official start of the catastrophic Asian financial crisis. On that day Thailand ran out of foreign-exchange reserves trying to defend its currency from a huge speculative attack. It was forced to float the Thai baht, which promptly plunged. The meltdown quickly spread as investors pulled their money out of countries with similar economic symptoms—especially Indonesia, Malaysia and South Korea.

Hong Kong, the Philippines, Singapore and Taiwan were also hit by the maelstrom. Never before had the world seen capital flight on such a scale and speed, causing financial markets and economies to collapse. Ten years on, many believe that these economies have fully recovered. But others think East Asia may be heading for another financial shock.

The crisis of 1997 was different from earlier troubles. Unlike in Latin America, where most emerging-market crises had happened, East Asia boasted low inflation, balanced budgets and a remarkable record of almost 8% average growth over three decades. This made the shock all the more unexpected and dramatic.

Looking back, however, Asia's flaws had been plain to see: a combination of weak financial systems, a hasty opening of economies to foreign capital and a policy of tying local currencies to the dollar. The expectation that currencies would remain fixed encouraged banks and other local firms to borrow heavily in dollars at lower interest rates than at home. As capital flooded in, these borrowings soared, as did property values and share prices.

Much of this cheap money was squandered, as prestigious offices and swanky apartments sprouted across the region. As the dollar rose between 1995 and 1997 so did East Asian currencies, causing current-account deficits to widen. In 1996 Thailand's deficit reached 8% of GDP. Once investors realised that this was unsustainable, capital took flight and the country's foreign reserves dwindled.

Once Thailand and others devalued, the crisis was about more than currencies. Devaluation caused foreign-currency debts to swell in local terms, resulting in widespread bankruptcies. Construction sites fell silent and their giant cranes stopped working as property bubbles burst and banks' bad debts soared.

Feeble regulation and supervision had allowed alarming mismatches between assets and liabilities, so banks started to fail, prompting yet more capital outflows.

In desperation Thailand even encouraged people to hand over their gold jewellery to be melted down to boost the central banks' reserves (pictured above). At its low point the Indonesian rupiah had fallen by 86% against the dollar. The currencies of Thailand, South Korea, Malaysia and the Philippines were all down by 40-60%; stockmarkets suffered losses of at least 75% in dollar terms. Thailand, Indonesia and South Korea were humiliatingly forced to go cap in hand to the IMF.

In 1998 Indonesia, Malaysia, South Korea and Thailand saw their real GDP per head shrink by an average of 11%. Many millions lost their jobs. Thailand and Indonesia, the two worst hit, suffered a slump in GDP during 1997-2002 of around 35% relative to their potential output (assuming growth at its previous pace)—as bad as America's output loss during its Great Depression in the early 1930s.

Some foreigners were quick—too quick—to pronounce the Asian economic miracle dead. Rapid growth, they claimed, had been a sham based on governments pouring cheap money into favoured firms. Over-borrowing and over-investment had artificially boosted growth. Doomsayers predicted a decade of lost growth, as in Latin America after its 1980s debt crisis. One notorious sceptic of the Asian miracle was Paul Krugman, who had argued before the crisis that Asia's growth was the result of “perspiration rather than inspiration”, based on increasing inputs of capital and labour rather than productivity gains, and would therefore prove unsustainable.

But the slump came from financial excesses, not poor productivity growth. Indeed, most estimates suggest that productivity growth in East Asia had been much higher than in other emerging or developed economies. It is true that strong growth concealed wasteful investment, inadequate bank regulation and corruption, but the chief ingredients of growth—a high saving rate to finance investment and open markets—remained in place.

This is one reason why most East Asian economies recovered more quickly than many expected. The IMF bail-outs also helped to restore confidence, bolstered by reforms to restructure and strengthen banking. Income per head returned to pre-crisis levels in South Korea and Malaysia by 2000; in Thailand and Indonesia it took until 2003 and 2004 respectively.

Asia vu?

Ten years later, Asia's financial markets are booming again and the region is once more the envy of the world. Emerging Asia has grown by an annual average of 8% over the past three years—as fast as before the crisis. Thus it might seem there has been a full recovery. Some economic commentators believe that, thanks to all that restructuring and reform, the victims of the crisis are now more dynamic and resilient than ever. Others, however, fear another crisis is in the making. Who is right?

The boosters are guilty of over-optimism. The 8% average for regional growth includes China and India, which are the fastest sprinters and also have much bigger economies than they did ten years ago. The Asian Development Bank (ADB) estimates that in the five East Asian economies worst affected in 1997-98, the trend annual growth rate since 2000 has slowed by as much as two and a half percentage points, compared with 1990-96, to an average of just over 5%.

The main reason for this is that investment has not recovered. Capital spending accounted for an average of only 24% of GDP in these economies last year, down from 35% in 1995 (see chart 1). This compares with an investment rate of more than 40% in China and is little higher than in many rich economies where investment opportunities should be much lower. Before the crisis, investment was probably too high; now it is too low.

Public infrastructure, particularly in Thailand and Indonesia, is worse than a decade ago and business spending has been hurt by economic and political uncertainty. Having had their fingers badly burnt, firms are still cautious about taking on debt. The ADB argues that governments could do much to change this: from investing more in education and infrastructure, to stamping down on corruption and improving the regulatory environment. For all the rhetoric about bold change, the truth is that reform has been relatively limited outside the financial sector.

Several studies suggest that quality of governance is important for investment and growth. And sadly, some aspects of East Asian governance have worsened. The ADB uses data compiled by the World Bank to rate Indonesia, Malaysia, the Philippines, South Korea and Thailand relative to the rest of the world on six measures of governance: accountability, political stability, government effectiveness, regulatory quality, the rule of law and control of corruption. Comparing 2005 with 1996, the scores for East Asia have got worse in 22 of the 30 comparisons (ie, six measures for five countries). If international rankings are compared, these countries have fallen in 28 of the 30 comparisons. Only in South Korea did governance scores improve on more than half of the measures.

Even in the financial sector more needs to be done. Banks are more resilient thanks to better internal controls and supervisory standards. Capital ratios have increased and non-performing loans have fallen sharply: in Thailand from 43% in 1998 to 8% last year. However, the healthier state of banks' balance sheets is partly due to favourable macroeconomic conditions, Philip Turner, of the Bank for International Settlements, points out. Strong growth and unusually low real interest rates have boosted banks' profits. And yet risk management remains poor in some countries. Capital markets, an alternative source of funds, are underdeveloped.

On the external side, however, the optimists are right to say that Asia is stronger and more resilient. The region is far less vulnerable to a balance-of-payments crisis than it was ten years ago, when all the crisis-hit countries had large current-account deficits. Now they all have current-account surpluses and much less foreign debt. They also have vast foreign reserves to protect them against any future speculative attack. As a rule of thumb, a country should have enough reserves to cover its short-term foreign debt. On the eve of the crisis in June 1997 South Korea's reserves were only one-third as big as its short-term debt; today they are twice the size. In most of the other countries, reserves are also two to three times bigger.

These large war chests mean that a repeat of 1997 is unlikely. However, some economists, such as Nouriel Roubini, of Roubini Global Economics, argue that the build-up of reserves is itself creating new hazards. East Asian policymakers, says Mr Roubini, failed to learn the most important lesson of the crisis. Exchange rates are once more, in effect, tied to the dollar. This, he argues, risks creating a new, but different financial crisis—not a balance-of-payments shock like last

Reuters

time, but booms and busts in asset markets.

As governments try to keep their currencies cheap, developing Asia's total reserves have jumped from $250 billion in 1997 to $2.5 trillion this year. The desire to build up reserves is understandable, but they are now excessive. Asian economies' policy of tracking the dollar and the consequent rapid increase in reserves, argues Mr Roubini, is leading to excessive growth in money and credit, inflationary pressures and asset bubbles in shares and housing. This, he concludes, will eventually lead to vulnerabilities similar to the massive capital inflows, credit boom, overheating and bubbles that preceded the 1997 crisis.

That was then

His grim prediction is based on the “impossible trinity”: an economy cannot control domestic liquidity and manage its exchange rate if its capital account is open. If it holds down its currency, foreign-exchange inflows will boost money growth. The central bank can try to “sterilise” the impact of bigger reserves by selling securities to mop up the excess liquidity. The snag is that bond sales will tend to push up interest rates and so attract yet more capital inflows. Mr Roubini believes that the room for sterilisation by Asian central banks is severely limited and so rising reserves mean even greater excess liquidity.

The big difference

However, these economies may be able to sustain today's policies for longer than Mr Roubini expects. This is because many of the economic characteristics he describes—such as fixed exchange rates, massive current-account surpluses and asset-price bubbles—certainly apply to China, but not to most of the smaller East Asian economies. To begin with, the chief victims of the crisis have let their currencies appreciate against the dollar by much more than China has. Only Hong Kong still pegs to the dollar. The South Korean won has risen by 42% since 2002 and the Thai baht by 28%. China accounts for most of the increase in Asian reserves. Since December 2004 the combined reserves of Indonesia, Malaysia, the Philippines, South Korea and Thailand have risen by only one-third; China's have doubled.

Second, the common claim that these economies have big current-account surpluses, which proves their currencies are undervalued, is much exaggerated. China has a big surplus, but of the former “crisis countries” only Malaysia has a large surplus (11% of GDP). South Korea, Thailand and Indonesia have an average surplus of less than 1% of GDP (see chart 2). Indeed, Morgan Stanley reckons these currencies are now overvalued against the dollar.

Third, in most countries the build-up of foreign-exchange reserves has not hugely pushed up the growth of money and inflation. The broad-money supply in the crisis economies is up by just over 10% on average over the past year, much less than China's 17% and well below their money growth of more than 20% in the mid-1990s. Inflation also remains tame. In its Asia and Pacific Regional Economic Outlook, the IMF concludes most emerging Asian economies are not on the verge of overheating. It sees little evidence of housing bubbles in most countries: average house prices have not risen by much more than incomes in recent years. Share prices have soared, but those gains follow sharp declines. With the notable exception of China, price-earnings ratios in East Asia remain below those in developed markets.

Foreign-exchange inflows are not causing money and credit to explode partly because central banks' sterilisation has been relatively successful in mopping up liquidity. One important difference between now and the years leading up to the crisis is that the upward pressure on currencies and the increase in foreign reserves almost entirely reflects current-account surpluses and inwards foreign direct investment, not net inflows of hot money. According to David Carbon at DBS, a Singapore bank, net capital inflows into the crisis economies have averaged only 0.5% of GDP since 2004, compared with 6.5% during 1991-96.

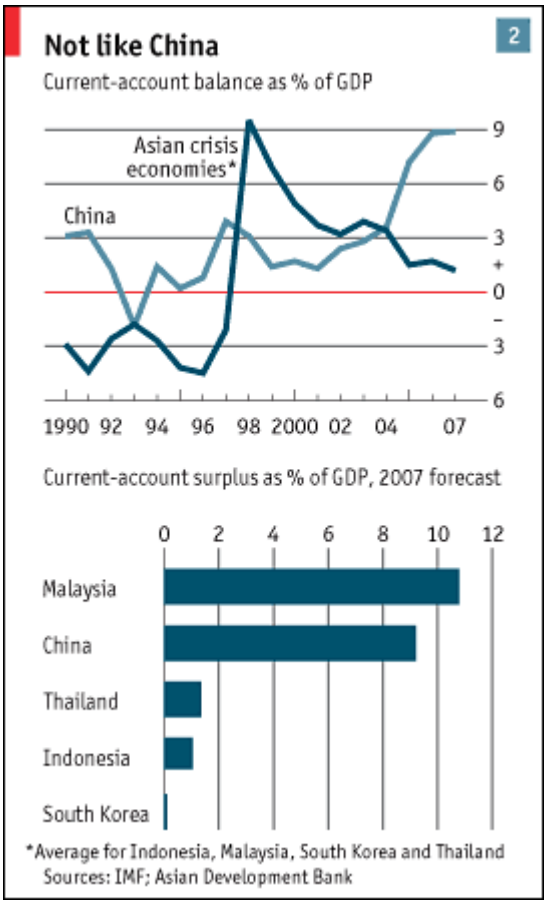
Only Thailand has seen large net capital inflows and last year it ran into trouble. Inflation started to rise, leading the central bank to lift interest rates. This pulled in yet more capital and pushed up the exchange rate. In December, to stem the rise of the baht and regain control of liquidity, the government made a bungled attempt to slap a tax on inward portfolio investment. The stockmarket plunged. In most of the other small Asian economies, however, central banks have not been deluged by net inflows of short-term capital. This may be why countries have been able to sterilise large amounts of foreign reserves without

attracting yet more capital.

Thus neither of the two commonly held views about the victims of the Asian financial crisis ring true. The economies hit hardest by the crisis have not fully recovered: their growth remains much slower than before 1997. But nor are they awash with excess liquidity and heading for another financial meltdown.

One big change over the past decade is the emergence of China as an economic power. Other Asian economies have lost some exports to China, but it imports large amounts of capital equipment and components from within the region. China's demand for raw materials has also pushed up commodity prices, benefiting some South-East Asian producers. China now takes 22% of the exports of the rest of emerging Asia, up from 13% in the late 1990s. Smaller East Asian countries have seen a slight decline in their share of global trade as China's has risen, but their exports have continued to grow rapidly. In the late 1990s, foreign direct investment in South-East Asia fell, stoking fears that China was stealing investment. However, over the past few years it has rebounded strongly. Overall, China has almost certainly been a net boost for the rest of Asia.

Nevertheless, the fear of losing competitiveness relative to China has played a big role in these countries' reluctance to allow their exchange rates to appreciate any more rapidly. If China allowed its currency, the yuan, to rise, they would have less need to intervene.



Wrong lessons

Could China be the source of the next crisis? China was less affected in 1997-98, thanks to strict capital controls. Indeed, by not devaluing its currency it helped to prevent a worsening of the financial contagion. But China, more than its neighbours, may have drawn the wrong lesson—namely the need to keep its exchange-rate stable and to build up massive reserves. China's monetary policy has been overly lax and low interest rates on bank deposits have encouraged a huge shift of money into its stockmarket. Thus Mr Roubini's diagnosis of Asia does apply to China.

If China's share-price bubble burst, the economic consequences in China—and among its neighbours—would probably be mild, since Chinese share-ownership is relatively low. Nervous investors might pull money out of other Asian stockmarkets, but large foreign reserves should prevent serious capital flight.

Rather than shielding themselves with big reserves, East Asia's governments should make their economies more pliable and their banks more resilient, and thus better able to cope with future volatility. They need more flexible exchange rates, which would not only prevent a further excessive build-up in reserves, but also help to shift growth towards domestic demand and away from exports. Governments must also restore business confidence and create a healthier investment environment. Asia has performed better than most people expected ten years ago. But it could have done better still.

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Credit markets

You only give me your funny paper

Jun 28th 2007
From The Economist print edition

Satoshi Kambayashi

Debt markets turn grouchy as creditors ask for more

BEFORE the brain was established as the body's ruling organ, the stomach was thought to be king. Descartes may have thought and therefore known that he was, but he reckoned that most of his moods were regulated by his guts. Credit markets seem never to have adjusted to this reordering, and still think with their stomachs. This week they were grumbling, and several big bond sales were postponed until they settle. “It's not a buyers' strike,” says Paul Read, a bond fund-manager at Invesco, “but a bit of indigestion.”

Until two Bear Stearns hedge funds got into trouble last week, things had been bubbling along merrily in the credit markets. Last year default rates on high-yield bonds fell to their lowest since 1981, according to Edward Altman of New York University. They have stayed low this year and, with healthy corporate profits and plenty of liquidity, there is no reason to suggest that is about to change.

Even so, there are signs that investors still holding American subprime mortgage debt might not be the only ones feeling a little queasy. In Asia a sizeable bond sale from MISC, the world's largest owner of liquefied natural gas tankers, has been postponed. In Europe Arcelor-Mittal, the world's largest steelmaker, put back a bond sale too. US Foodservice, an American wholesaler, has made such hesitance look like a trend by delaying plans to raise $2 billion in loans. That spells trouble for even bigger issues on the horizon, like the $62 billion that Cerberus Capital Management, an investment firm, hopes to raise for Chrysler, which it is buying.

Although modest repricing is going on, investors are still willing to take risks if they are paid a little more to do so, and plenty of deals are still going ahead. Yet all is not well. “There's so much leverage in the system that it wouldn't surprise me to see more problems,” says Jim Reid, credit strategist at Deutsche Bank. The place to look for a decisive shift in sentiment is in the buy-out market, which has been fuelled by a trio of habits that in more sober times would have had lenders reaching for the Alka-Seltzer.

The first of these lies in the burgeoning market for “covenant-lite” loans. Loans normally require borrowers to maintain financial thresholds, like limiting debt to five times cashflow. But a huge number are now lacking such “maintenance covenants”, which means that banks have less grip on borrowers when business turns sour. The total amount of covenant-lite loans issued in the first two quarters of 2007 has been $105 billion, which tops the $32 billion of all such loans written from 1997 to 2006, according to Standard & Poor's, a rating agency.

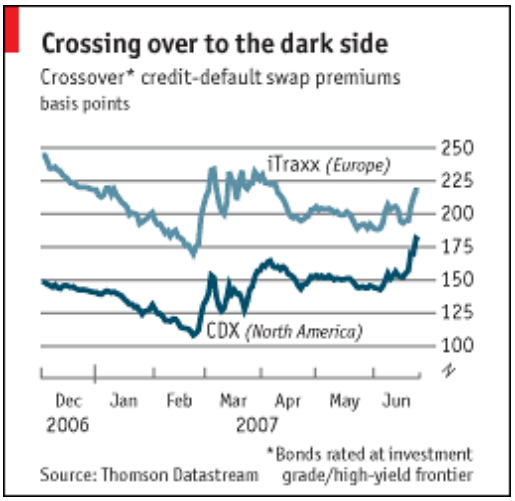
The largest issuers of the covenant-lite loans are private-equity firms, which have been able to dictate terms to lenders. Kohlberg Kravis Roberts (KKR), a big buy-out firm, filed to raise a record $16 billion of such loans last month to finance its buy-out of First Data. Covenant-lite loans now account for almost 35% of all loan issuance in America. Many such loans are issued as senior-secured debt by stronger borrowers, making many of them safer than sub-prime residential mortgages.

Buy-outs financed by covenant-lite loans are less likely to fail early (there are, after all, no covenants to break as the company deteriorates). But if a wobble in asset-backed securities caused investors to demand more to hold them, the buy-out market would suffer. Only last week Thomson Learning, an education business, found it surprisingly hard to issue covenant-lite loans as investors grew squeamish.

A second place to watch for changing appetites to risk is in bridge finance. Up until last year, when a buy-out fund wanted to bag a big company it usually had to club together with other funds to increase its firepower. Now it is the norm for banks to provide bridge loans or equity to finance part of the deal. Through bridge equity, Blackstone was able to swallow Equity Office Properties, a property business, without installing too many cooks in the boardroom or having to share its ideas with competitors. This arrangement suits investors, who run the risk of being exposed to the same deal from several angles when private-equity funds club together. As a further inducement, bridge-equity finance also increases what those hard-up folk at Blackstone can expect to make on any upside of their deals, since they get the carry on the bridge-equity too.

The banks collect fees for raising the finance and for syndicating it. Bridge-equity finance can also be a way for them to get exposure to private equity. But, like supermarkets piling up discounted DVD players at the front of a store in the hope of luring customers in to splurge on cream cakes, the banks hope that funds who take these loans will go on to buy advice on mergers and debt-financing too, at which point the banks make their real money. If it goes wrong, they get left holding the equity.

Not all bankers think this is a good trade. “It's an appalling business for the banks,” says a banker at a bulge-bracket firm more used to taking risks than balking at them. “It is the wrong use of your capital,” Klaus Diederichs of JPMorgan said at a seminar on June 26th. “It's crazy and we hope it goes away.” Perhaps this wish is already being fulfilled. The day before he spoke, managers at a big private-equity fund based in New York were muttering in their Monday morning meeting that such loans were becoming harder to come by.



That leaves a third bellwether for the buy-out market. Some firms bought by private equity have been issuing payment-in-kind (PIK) notes. These allow them to pay interest in the form of further loan notes, rather than hard cash. This further weakens the hands of creditors, adds to the sum of risky paper blowing around and makes investors wonder who owes money to whom. Harsher terms on PIKs would be further evidence of a shift in sentiment. Potential buyers of US Foodservice's debt reportedly balked at both the PIKS and also the lack of covenants.

There are other indications that the appetite for risk is heading down, albeit from somewhere a few thousand feet above the peak of Everest. On June 27th the VIX, a measure of stockmarket volatility (otherwise known as nervousness), rose to 19%. It has been higher only once this year. The yen has appreciated, which is a sign that the buccaneering spirit reflected in the carry trade is waning a little (since unwinding this trade involves buying the currency). After lurching upward in early-June, the yield on American Treasury bonds has been falling, reflecting a stronger demand for safe investments. And spreads on high-yield bonds have widened. None of which means disaster is on the way. But it may leave a sickly feeling, something like a knee to the stomach.

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Private equity

Polish needed

Jun 28th 2007
From The Economist print edition

Private-equity firms needlessly squirm in the spotlight

PUBLIC companies are often told they have lots to learn from private-equity firms. But the reverse is also true. Private-equity firms could take lessons from their listed counterparts about being in the public eye. In America reporting of the lobster-filled life of Stephen Schwarzman, the chief executive of Blackstone, a private-equity firm that floated on the New York Stock Exchange on June 22nd, has been a gift to critics. If access to credit becomes tighter and private-equity-owned firms go bankrupt, scrutiny will only increase. After a strong start, Blackstone's share price dipped below the offer price on June 26th on fears of (among other things) an imminent peak in the buy-out cycle.

In Britain too, private-equity firms have been ham-fisted in their public presentation. Their only clear message has been “don't take away our tax breaks”, says one British PR boss. Historically, private-equity firms have treated public relations as tactical, says Kathy Bloomgarden, boss of Ruder Finn, an agency. PR firms are used to explaining a transaction; dinners and conferences help raise the firms' profiles with executives who may be harbouring ambitions to manage a buy-out; but Ms Bloomgarden sees scant evidence yet of private-equity firms engaging in external communications.

That is unsurprising: by habit, private equity has operated out of the limelight. Focused dealmakers are not always cut out for PR. Mr Schwarzman's aggressive style is certainly hard to soft-soap (“I want war, not a series of skirmishes,” he told the *Wall Street Journal* in a recent interview). The pity is that the industry has a strong story to tell. A new survey of more than 250 executives carried out by the Economist Intelligence Unit, a sister company of *The Economist*, reveals broad agreement among business-minded folk that private-equity firms are good for the health of an economy and improve the firms that they buy.

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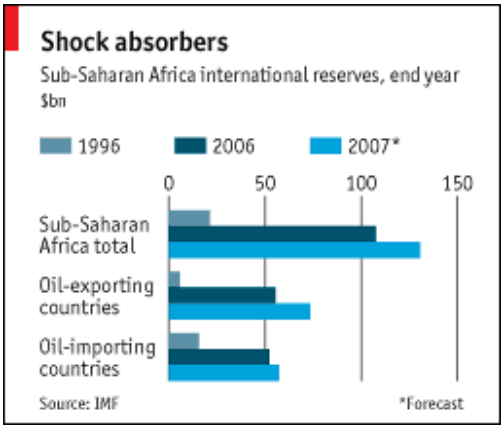
African foreign-exchange reserves

Saving up for a rainy day

Jun 28th 2007 | JOHANNESBURG
From The Economist print edition

Africa buys itself a bit of insurance



WHY is the world's poorest region stocking up on hard currency? Over the past ten years, sub-Saharan Africa's international reserves have grown fivefold—from $21 billion in 1996 to $108 billion last year (see chart). This year they are expected to near $131 billion. Globally, reserves have tripled on average during the same period and, according to the IMF, even the developing world has failed to match Africa's stockpiling. In the past, much of the money would have found its way into rulers' pockets, or into white paint splashed over an elephant or two. That may still go on, but more prudent housekeeping is also becoming a habit.

True, much of the increase has come from oil-producing countries, where reserves went from just under $6 billion at the end of 1996 to $56 billion at the end of 2006. They are expected to reach $74 billion by the end of this year, as higher oil prices continue to boost export revenues.

But for the region as a whole, this is about more than luck with the commodity cycle. Oil importers have also managed to improve their positions. South Africa, with over $23 billion in its vaults, has enough reserves to cover more than three months' worth of imports.

And poorer African countries less endowed with oil or minerals are also saving up. Uganda and Lesotho sit on reserves worth about six months of imports. Overall, the region's reserves are climbing faster than its foreign trade, and partly thanks to the write-off and repayment of foreign debt, liquidity ratios are improving. Zambia's reserves, for example, amounted to less than 1% of its foreign debt in 1998. They are now equivalent to about 28%.

According to Goolam Ballim, an economist at South Africa's Standard Bank, the build-up of foreign-exchange reserves is the result of better economic policies and an effort to reduce external vulnerabilities. Except for spectacular disasters such as Zimbabwe, where the economy has nearly halved in size since 1999 while inflation orbits at around 4,500%, most African governments are trying to stabilise their notoriously precarious economies. Many are enjoying faster growth, lower inflation and better public finances.

Higher reserves are an insurance policy against the slings and arrows of economic fortune. Among emerging markets, the region is usually the last to enjoy the fruits of bullish sentiment and the first to feel the effects when rich investors flee to safety. Most African economies remain dependent on subsistence agriculture and, hence, the weather. Those with commodities to sell suffer from the vagaries of global prices. And because domestic financial markets are very thin, most African countries hold a large part of their debt in foreign currency, which is especially hazardous when local currencies plunge.

Already this insurance policy is paying dividends. According to Benedicte Christensen, of the Africa department of the IMF, there have been fewer requests for help from sub-Saharan Africa than there were the last time oil prices soared. Indeed, the IMF may be ready to give the countries that are still in its long-term care a bit more latitude. In the past, it has insisted that governments with inadequate reserves hoard any foreign-aid increases, rather than spend them on imports. The new prudence shown by many African governments should allow them to make better use of foreign charity.

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Buttonwood

Identity crisis

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From The Economist print edition

As the line blurs between hedge funds and banks, a bit of mystique goes missing

Get article background

PEOPLE have trouble defining the term hedge fund. For some it simply conveys an aura of big money tinged with a dashing hint of menace. But within a few years the term may be even more meaningless than it is now, because hedge funds are rapidly becoming indistinguishable from the rest of the financial-services industry.

D.E. Shaw, an American group, is a case in point. It started as a “quantitative” manager, using sophisticated computer models to pick stocks and, with $26 billion under management at the end of 2006, was ranked as one of the four largest fund groups in the world.

But hedge funds were only the beginning; there is barely a financial activity in which D.E. Shaw is not now involved. In early June it announced a bid for James River, an insurance firm. The group already has an arm, Laminar Direct Capital, that makes direct loans to firms. It has considered moving into private equity and owns FAO Schwarz, a big toy store. As well as running hedge funds, it operates a “long-only” business, which buys assets in the hope they rise in price.

As hedge funds like D.E. Shaw move in one direction, investment banks and conventional fund managers are shifting in the other. Many have bought hedge-fund groups outright (such as JPMorgan Chase's purchase of Highbridge Capital Management) or have taken minority stakes in them (Lehman Brothers bought 20% of D.E. Shaw in March). Others either operate funds-of-hedge-funds (Goldman Sachs) or have set up separate hedge-fund arms (Gartmore and—less successfully of late—Bear Stearns).

There also seems to be a growing belief that there is more to investment than long-only management. The latest fashion is 130/30 funds, which use borrowed money to combine 130% long positions with 30% short (betting on falling prices). According to this philosophy, stopping fund managers from shorting stocks is like preventing Tiger Woods from using all the clubs in his bag; smart investors should be able to spot overpriced stocks as well as underpriced stocks. Such products, which have been dubbed “hedge funds lite”, allow investors such as pension funds to take their first steps into the world of “absolute return” investing.

It is not too difficult to work out why banks and traditional fund-management firms should want to be more like hedge funds. For a start, the annual management fees are a lot higher. Second, as the flotations of Fortress and Blackstone, two large and varied alternative-investment firms, have shown, the stockmarket is willing to pay a very high multiple for companies that earn performance fees.

But why do hedge-fund groups want to move the other way? Part of the reason is the Darwinian environment in which they operate. They are constantly on the lookout for markets that are inefficient or areas that offer excess returns. In banking and insurance, for example, hedge funds may benefit because they lack either the costly infrastructure or regulatory burdens that impede the traditional operators; borrowers say hedge funds are much quicker than banks at deciding whether to make a loan.

For the individual hedge-fund manager, diversifying makes sense. Some strategies may be profitable for a while, but then have bad years, as convertible-arbitrage managers found out in 2005. If returns are bad enough, the business can disappear overnight. But that is far less likely to happen with a range of strategies.

There is a further level of protection if the manager raises “permanent capital” by issuing shares. Hedge-fund investors have the right to withdraw their capital, subject to lengthy notice periods. But if the manager is running a listed fund, investors can redeem their holdings only by selling them on the open market; the annual management fee is unaffected.

Permanent capital can also be raised in a different way if the hedge fund issues bonds (as Citadel did last year) or floats shares of the management company (this week London-based GLG Partners became the latest to aim for a New York listing). Such capital-raising exercises allow founders to cash in their holdings and also give the hedge funds some independence from their prime brokers, on whom they depend heavily when borrowing money.

But flotations also force hedge-fund managers to be more transparent, diluting the mystique on which their high fees partly depend. And they accelerate the process by which boutiques turn into broadly based financial groups, with all the bureaucracy that implies (bureaucracy that many managers went into the business to escape). Hedge funds may be gaining fame and fortune as they expand, but they may be losing part of their soul.

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Trade talks

Mangling trade

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From The Economist print edition

Global trade talks suffer a familiar outcome, but for an unfamiliar reason

Get article background

SUNGLASSES, hairbrushes, picks, hoes, nuts and bolts—this is just a sampling of the goods China is alleged to have dumped on the markets of manufacturing rivals such as Brazil, Argentina and South Africa in recent years. Hard-pressed companies complain to their politicians of “floods” and “invasions”, destroying whole industries and inflicting “horrific injury”.

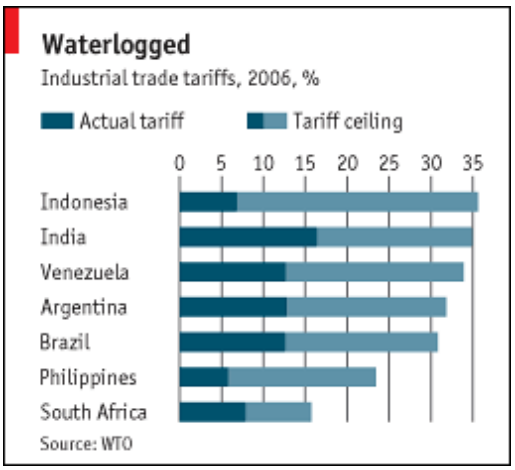
The cause of all this angst was not present at last week's trade talks in Potsdam, where ministers from the European Union, America, Brazil and India failed once again to narrow their differences in the interminable Doha round of negotiations. But it seems the fear of China was well represented. As a result, a new excuse to fail to agree was found.

Previous summits have broken down over agriculture. This time, however, the Europeans decided not to push America too hard on its farm subsidies, and the Americans did not demand too much from a Europe notoriously reluctant to open its agricultural markets. Thus America offered to cap its trade-distorting handouts at $17 billion, lower than its previous offer ($22 billion), but rather more than it actually spent last year ($11 billion). In return, the Europeans now seem willing to cut their agricultural tariffs by about half on average.

Thanks to this new-found unity in mediocrity, the talks turned from agriculture to industry, and from the rich world to Brazil. The populous and increasingly prosperous emerging markets that Brazil represents in these talks are of growing interest to exporters in the rich world. This gives the Brazilians a bargaining chip. The question is how much can they get for it.

In Potsdam the Brazilians decided that America and Europe were offering too little and demanding too much. In return for modest concessions on agriculture, the two powers were seeking cuts of 50-60% in industrial tariffs, as the Brazilians saw it. The “level of ambition” in each strand of the talks was thus out of kilter. Nonsense, the Americans and Europeans retorted. They said they were asking for reductions in industrial tariffs of just a few percentage points overall. Could both sides be right?

In WTO negotiations, countries haggle not over tariffs, but over tariff ceilings. In many cases, however, these mutually agreed ceilings give countries much more latitude than they choose to use. Brazil, for example, has pledged not to raise its duties on industrial goods above about 30% on average. But the duties it actually imposes average less than 13% (see chart).



The gap between these two numbers is known as “water” in WTO-speak. After the liberalising wave of the past two decades, in which countries decided to open their economies without waiting for others to do likewise, there are now big gaps between actual tariffs and allowable ones. Exporters fear the Doha round will amount to little more than a mangle, squeezing water out of the trading system.

For example, Brazil, Argentina and others have offered to lower their ceilings by over 40%. But this proposal would trim the tariffs Brazil and Argentina actually impose by less than a percentage point, the WTO has calculated. Even the more ambitious efforts urged by America and the EU would shave only about three percentage points off the South Americans' average.

Why all the fuss then? Behind these averages lies a lot of variation. A handful of industries cowers behind

barriers that brush close to the WTO ceilings. For example, South Africa's garment-makers enjoy a tariff of about 40%; its carmakers one of 30%. As a result, South African assembly lines still turn out a slightly modified version of the original Volkswagen Golf, decades after it disappeared from production elsewhere. Under any Doha deal, South Africa's government would be permitted to spare some lines of business from the full force of the cuts, but it would “have its hands full parcelling out the pain”, observes Peter Draper of the South African Institute of International Affairs, a think-tank based in Johannesburg.

In Latin America the types of goods China exports face tariffs about 9% higher than average, according to a recent study published by the World Bank. A Doha deal would take a bigger bite out of tariffs the higher they are. But not all of Brazil's peers are allowing fear of China to paralyse them. After the Brazilians left Potsdam in a huff, Mexico joined with Chile and six other middle-income members to try to revive the round, by showing a bit more ambition on industrial tariffs. Perhaps they appreciate cheap sunglasses.

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Mobile payments

Dial M for money

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From The Economist print edition

Beating banks at their own game

Get article background

IT HAS already changed most people's lives, but there is more work ahead for the mobile phone. The trusty SIM card can also act as a debit and credit card. That means it may only be a matter of time before mobile phones are used to deposit, transfer and withdraw cash.

In the developed world, one of the barriers hindering the switch to mobile cash has been the costly infrastructure developed by banks and credit-card companies. With cash machines and bank branches at every street corner there is less call for an alternative payment system.

But out in the African bush, progress is marching to a different drumbeat. In Kenya, where bank branches are few and far between, M-PESA, a mobile-payment scheme run by Vodafone, a telecoms firm, and Safaricom, a Kenyan operator, with the backing of the British government's Department for International Development, has created an alternative to banks. Most M-PESA customers have no bank account, but they withdraw cash and make payments or send money using their mobile phones. Their cash points are a network of airtime sellers dotted around the country—Safaricom shops, petrol stations, or any other shop used to handling cash. Once they have verified a customer's identity via their telephone number, the agents will facilitate a transaction. M-PESA keeps tabs on all the money and the float is held in a single account at the Commercial Bank of Africa in Nairobi.

Thus M-PESA has created its own financial system, including clearing and settlement. Kenya's central bank tolerates it, as long as M-PESA does not pay interest or invest the float. After a full roll-out in March, it already has around 500 agents and 150,000 customers, says Nick Hughes of Vodafone. The system could easily operate across borders. Even now, a pilot scheme enables people to send expatriate remittances to Kenya via the M-PESA system.

The beauty of M-PESA, for those who would like to see competition with bank-sponsored payment systems, is that no bank is involved except as a holder of the float. In theory, the European Commission is encouraging similar competition with its new payment-services directive (PSD), due to come into force in 2009. The PSD foresees the development of non-bank “payment institutions” which need no banking licence if their activities are restricted, though of course they would be subject to anti-money-laundering controls.

However, a European version of M-PESA might be thwarted by other moves to facilitate cross-border payments, according to Ivan Mortimer-Schutts of the Paris-based Groupe d'Economie Mondiale, a think-tank. In his view (admittedly, his research was commissioned by Vodafone) the prospect of a bank-dominated Single Euro Payments Area, over which there has been much foot-dragging, may have dissuaded mobile-phone companies and other non-banks from innovating in the payments arena. It may be time to call Kenya for a word of advice.

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Japanese banks

Fishing for a future

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Healthy at last, the big banks now need a strategy

EPA

Time to widen the net

IF JAPAN'S biggest banks have put their rotten past behind them, they are still in search of a future. At long last, 17 years after the bursting of Japan's bubble, banks' energies are no longer consumed by how to deal with crippling bad loans. At the six biggest banking groups the ratio of non-performing loans (NPLs) to total loans continues to fall—to 1.5% this spring, down from a scary 8% or more at the height of the banking crisis in 2002. Admittedly, the regional banks still have more to do, since their average bad-loan ratio stands at 4%. Meanwhile, the many local credit co-operatives are stuck with bad loans equivalent to over 7% of all their lending. Still, for Japan's bigger banks, not only are bad loans no longer a problem but government money lent to keep the banks afloat has nearly all been paid back. The task has shifted from survival to making money.

That is less grim, perhaps, but the prospect of handsome profits remains alarmingly elusive. In the financial year to the end of March, net profits at the biggest banks fell by nearly one-tenth, to ¥2.82 trillion ($23.5 billion), according to Standard & Poor's (S&P), a rating agency. This was down from record levels of profits a year earlier, when an improving economy meant that not all the loans for which banks had made loss provisions proved to be duds.

This happy trend is near an end, without cast-iron ways to make money in future. Much hope has been placed in the central bank's determination to “normalise” the country's monetary policy. For years the Bank of Japan had set interest rates at zero in an attempt to deal with persistent deflation. Last year it began a slow process of raising rates; today, the key lending rate stands at 0.5% and it is expected to rise to 1% by next spring. Rising rates are supposed to be a boon for Japan's commercial banks, because the rate paid to depositors tends to go up more slowly than that charged to borrowers.

Since the middle of last year the interest rate that banks charge for loans has indeed crept up, from 1.3% on average to over 1.6%, and spreads on new loans are widening. Yet average spreads in Japan, according to S&P, remain just one-third of the 3% or more charged in America. And as Richard Katz of the *Oriental Economist* points out, loan growth, even if it has turned positive, remains anaemic, at about 1% a year. Lending will not be a money-spinner for a long time to come. The problem, as with so much else in Japan's economy, is one of excess saving. Though households have reduced their levels of savings in recent years, companies are sitting on huge piles of cash, much of it deposited with the very banks that hope to lend to them.

So banks are casting their net wider. Retail customers, once disdained, are being courted. The experience is not always a happy one. Consumer finance was until recently highly profitable, thanks to rates of up to 29% charged to some borrowers. Japan's three “megabanks”—Mizuho, Bank of Tokyo-Mitsubishi UFJ and Sumitomo Mitsui—had each acquired consumer-finance companies. Yet legislation passed late last year set a cap on rates and even allowed borrowers to reclaim interest already paid. The provisioning that has ensued has been painful. Foreign-managed Shinsei is often regarded as the Japanese bank with the best retail strategy. It swung from a net profit of ¥76 billion to a loss of ¥61 billion in the latest financial year.

The biggest banks have had better success selling investment products to household customers. People are slowly venturing into riskier assets to raise the paltry returns on their savings. For instance, they bought nearly ¥13 trillion of investment trusts (Japanese forms of mutual funds) last year, and their appetite for foreign securities is growing. After a decade in the business, banks are for the first time outselling brokers in investment trusts, which earn large fees. However, Japan's Financial Services Agency

(FSA) is concerned that banks are inadequately briefing customers on the risks. In June the FSA castigated the country's biggest banking group, Bank of Tokyo-Mitsubishi UFJ, for mis-selling investment trusts and then failing to compensate customers for losses.

The most ambitious route to future profits lies with investment banking, at home and overseas. Here, Mizuho leads the charge. Hiroshi Saito, head of Mizuho Corporate Bank, insists that lending cannot lead to large future profits. Instead, it is through securitisation, risk management, proprietary trading and derivatives that Mizuho must catch up with American investment banks, he says.

For the time being, the Japanese government appears keen to help the likes of Mizuho. The FSA has recently announced a determination to reconfigure Japan's firewalls between banking and securities businesses in a way that would allow financial groups to serve customers better, as well as more safely to manage risk. It is a start, but there is a long way to go. Because Japanese bankers, says one of them, struggled with NPLs for so long, they slept through some radical changes in finance these past few years.

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Economics focus

An unhealthy burden

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America's health-care market is not as unfettered as it seems

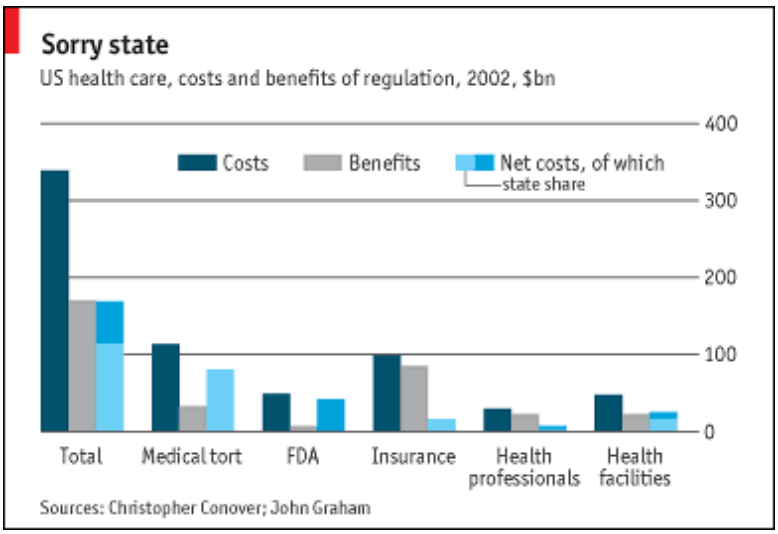
TO MANY outside the United States, America's health-care system might seem an example of capitalism at its rawest. Europeans and Canadians enjoy universal health care and cheap drugs thanks to government-run systems, the argument goes, but the market-based approach taken by the world's richest nation leaves many millions uninsured and leads the rest to pay the highest drugs prices in the world. Such doubts are sure to be reinforced by this week's release of Michael Moore's "Sicko", a much-trumpeted new film on health care that bashes the free-market Yankee model even as it praises the *dirigiste* alternative north of the border.

So is America's health system really red in tooth and claw? Hardly, according to a growing body of academic evidence. As a result of interference at the federal and state levels, health care is one of America's most heavily regulated industries. Indeed, its muddled approach to health-care regulation may act as a massive drag on the American economy—what one expert has called "a $169 billion hidden tax".

Costing an arm and a leg

That figure comes from a path-breaking study* of a few years ago by Christopher Conover of Duke University. It looked at the many ways in which the American legal and regulatory systems affect the provision of health services and lumped them into five categories: medical torts; the Food and Drug Administration (FDA); insurance regulation; and the certification of both health professionals and health facilities. His team concluded that the overall benefit to society of $170 billion per year delivered by this system of oversight was far outweighed by the $339 billion in annual costs that it imposed (see chart). Even ignoring the cost of big federal tax breaks for employer-sponsored health insurance (which Mr Conover left out), his study estimated that the net cost of America's health regulations resulted in perhaps 4,000 extra deaths each year and was responsible for more than 7m Americans' lacking health insurance.

Building on this point, a forthcoming paper† by Michael Cannon of the Cato Institute, a libertarian think-tank in Washington, DC, investigates the biggest federal component of this regulatory burden: the FDA's oversight of pharmaceuticals. It notes that some 20 cents out of every dollar spent by consumers goes on purchases under the purview of the FDA, which it calls "one of the most pervasive federal agencies in the country."



Citing the best evidence to date on the costs and benefits of FDA regulation, Mr Cannon argues that the

agency “is too slow and demands too much testing”, ultimately harming consumers. He points out that drugs regulators can make two broad types of errors. First, they might approve a drug too quickly, only to find out after its launch that it is dangerous or even deadly. Second, they could delay the launch of a highly innovative drug by demanding onerous or unnecessary trials and thereby deny many needy patients a new therapy.

Proper regulation requires balancing these two risks, but the pitch may be queered by bureaucratic self-interest. If the regulator allows even one drug to slip through the approval process that later proves harmful to some people some of the time, a hue and cry is sure to follow. Look no further than the recent public backlash against the FDA after several deaths were linked to Vioxx, a blockbuster pain remedy made by Merck.

And yet the second (and probably bigger) risk of leaving people untreated because of restrictions on drugs rarely gets the regulators into trouble. As Mr Cannon puts it, “no FDA official has ever been fired or faced a congressional inquiry for delaying the approval of a promising new drug, however unjustified the delay.” What is more, he speculates, big drug firms may quietly acquiesce to this burdensome red tape because it acts as a barrier to entry against newcomers without the cash or lobbying power to navigate the FDA.

The FDA's caution may result in the biggest federal “tax” on health care identified by the Conover study but an even bigger component is to be found in America's distorted system of malpractice insurance, which is regulated at the state level. That is the conclusion of John Graham of the Pacific Research Institute (PRI), a think-tank in San Francisco. In a paper†† published this month, Mr Graham has taken Mr Conover's federal analysis and applied it to all 50 states. The idea is to rank which states allow Americans the greatest amount of “health ownership”.

Mr Graham's analysis concludes that because regulation of health insurance and overzealous pursuit of medical torts are both typically handled at the state level, states are to blame for most of that $169 billion annual burden imposed by excessive health-care regulation (as the chart also shows). The heavy-handedness, he notes, includes groups of surgeons being denied permission to open specialist clinics because rival one-size-fits-all hospitals invoke state regulations protecting their patch. Meanwhile, enterprising “nurse-practitioners” are blocked from offering simple treatments at inexpensive clinics by state rules requiring costly supervision by doctors.

New York—a liberal bastion and home to Hillary Clinton, who in the 1990s unsuccessfully advocated a sweeping reform of America's health provision—comes out rock bottom on the PRI ranking of health freedom. That will undoubtedly please conservatives who still deride her earlier proposals for a government-run health system, which they dub “HillaryCare”. But the unstated and awkward inference of these studies will not. If America's health-care regulations are as costly as they claim, the system is merely masquerading as a free-market model and may be no better than others.

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* A Review and Synthesis of the Cost and Benefits of Health Services Regulations", Christopher Conover, Duke University, July 2003.

† "Do Economists Reach a Conclusion on the Food and Drug Administration?", Michael Cannon, Cato Institute, forthcoming.

†† "US Index of Health Ownership", John Graham, Pacific Research Institute, June 2007.

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Space psychology

Cosmic mood-swings

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Why human psychology will make sending people to Mars hard

Stephen Jeffrey

ONE of the two reviews posted on Amazon.com about Valentin Lebedev's “Diary of a Cosmonaut” calls it a “profound” book “about what it's like to be in a flying tin can for more than half a year”. The other reviewer would “not recommend reading its pages to [his] worst enemy”. He thinks Dr Lebedev's account of months of increasingly territorial behaviour and flagging conversation with his lone colleague on the good ship *Salyut 7* is a “painfully boring” portrayal of why human space exploration is as pointless as it is frivolous.

Dr Lebedev's mission would, nevertheless, seem entertaining compared with a trip to Mars. The round trip, including a stay on the surface, would take about 17 months. Which is why it is surprising that within a few days of its being advertised, more than 3,000 people have applied to take part in an experiment planned by Russia's Institute for Biomedical Problems and the European Space Agency (ESA) to simulate such an outing.

Even at the speed of light (and therefore radio), the trip from Earth to Mars and back can be as long as 44 minutes. Any conversation with home would therefore be pretty dreary. Indeed, just looking at Earth would be dull. The planet would appear as a tiny speck, with neither blue ocean nor swirling, white cloud visible. Nonetheless, hordes of willing guinea pigs have been gumming up ESA's switchboard all week, desperate to experience utter tedium in the name of science for longer than humans ever have willingly done before.

Odd, indeed. But it may have something to do with a television programme called “Big Brother”, which has spawned national versions throughout Europe and beyond. Much like “Big Brother” contestants, the three groups of six who will be locked into simulation modules in Moscow will be ordered to complete tasks while others observe their behaviour. Those tasks have yet to be decided. But a pretend take-off, an exploration of a fake Martian surface and dealing with fictitious media headlines are on the cards. Unlike “Big Brother” wannabe C-list celebrities, the pretend cosmonauts will have to speak fluent Russian and English and keep track of nearly two years' rations. None will be kicked out by popular vote (indeed, doing so in space would cause them to explode).

Thumb-twiddling in free-fall

The experiment's popularity is all the more bizarre given that Dr Lebedev is far from the only cosmonaut whom space has driven a bit cranky. Half of all cosmonauts have developed a condition that Russian psychologists call “asthenisation” (and American ones do not recognise). This is characterised by irritability and low energy. Crew members often get on badly with each other. Individuals develop “space dementia”. Orbiting astronauts have even become clinically depressed and panicked at psychosomatic illnesses.

Nick Kanas of the University of California, San Francisco, and his colleagues have scrutinised seven years of interactions between crew and ground staff during missions to the International Space Station (ISS). Those years included eight missions that maintained, through overlapping individual stays, at least three astronauts on the ISS at all times. The 17 crew members involved, and the 128 mission controllers, rated the social climate of the mission and also their own emotional states in weekly questionnaires, beginning a month before launch and ending a fortnight after a mission had returned to Earth.

Dr Kanas's analysis of the answers is published in the June issue of *Aviation, Space, and Environmental Medicine*. It is broadly consistent with his smaller study of missions to *Mir*, the Soviet Union's first space station. Over the course of both the *Mir* and the ISS missions, there were no overall trends in the quality of social interactions during the course of a mission. That is reassuring, but only slightly. Before his analysis of the *Mir* data, Dr Kanas had expected the mood on space stations to dip during the third quarter of a mission, as often happens on submarines and Antarctic research stations. That it does not implies that the psychological tactics of ground-control medics are working.

Of the 82 person-years spent in space, two-thirds have been notched up by Russians. Thus it was Russian support staff who first learned to monitor their cosmonauts' speech rhythms for early signs of strain, and arrange surprise gifts in supply ships and cheery telephone calls from famous people and family members in response. But presents and real-time interaction with Earthlings would be impossible on a Mars mission, which would be more similar, psychologically, to heading into the sunset with Ferdinand Magellan than to joining a trip to the moon in *Apollo*.

Yet Dr Kanas's study also uncovered a more worrying finding. As with his *Mir* study, and by all six of his measures, the ISS crew coped with stress by blaming the ground team and perceiving that its members felt negatively towards them—even though the records of mission controllers showed that they did not.

This tendency to convert tensions on board into feelings that people on Earth do not care is one reason why sending people to Mars would be as much a psychological as a technical challenge. Indeed, one of the crews of *Skylab*, NASA's first attempt at a space station, became so annoyed with mission control during their 84 days in space that they mutinied, sulked and turned off all communication.

Some psychologists propose sending an all-female crew to Mars. Even if women become irritable, they are less likely to commit suicide or murder each other than men are. Others think a mixed team would support each other better. But that, as the European experiment may demonstrate, raises the possibility of the first human Martians. Perhaps it would be better to stick to more psychologically robust and less libidinous space explorers: robots.

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Particle physics

Down the rabbit hole

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America's chances of finding the source of universal mass receive a boost

“OH DEAR! Oh dear! I shall be too late!” So muttered the White Rabbit just before he plunged into Wonderland, with Alice in pursuit. Similar utterances have been escaping the lips of European physicists, as it was confirmed last week that their own subterranean Wonderland, a new machine called the Large Hadron Collider, will not now begin work until May 2008. This delay may enable their American rivals to scoop them by finding the Higgs boson—predicted 43 years ago by Peter Higgs of Edinburgh University to be the reason why matter has mass, but not yet actually discovered.

The Large Hadron Collider is a 27km-long circular accelerator that is being built at CERN, the European particle-physics laboratory near Geneva, specifically to look for the Higgs boson. When it eventually starts work, it will be the world's most powerful particle collider. It will also be the most expensive, having cost SFr10 billion ($8 billion) to build. The laboratory had hoped it would be ready in 2005, but the schedule has slipped repeatedly.

The most recent delay came at the end of March, with the dramatic failure of a magnet assembly that had been supplied by CERN's American counterpart, the Fermi National Accelerator Laboratory (Fermilab) near Chicago. This device was one of four designed to focus beams of particles before they collide in the experimental areas. Admittedly, it had been placed under extreme conditions when it failed, but such forces are to be expected from time to time when the machine is running normally. The magnets have yet to be fixed, although physicists think they know how to do it.

Other, smaller hitches have compounded the problem. The collider has been built in eight sections, each of which must be cooled to temperatures only just above absolute zero. This is because the magnets used to accelerate the particles to the high energies needed for particle physics rely on the phenomenon of superconductivity to work—and superconductivity, in turn, needs extremely low temperatures. Unfortunately, the first of the eight sections took far longer to chill than had been expected.

If, as the other seven sections are cooled, further problems emerge, the start date will have to be put back still further. It takes a month to cool each section, and a month to warm each one back up to normal temperatures again. If it took, say, a month to fix any problems identified as a section cooled, each cycle would postpone the start date by three months.

To accelerate progress (as well as particles), CERN's management decided last week to cancel an engineering run scheduled for November. Instead of beginning slowly with some safe-but-dull low-energy collisions, the machine's first run will accelerate its particles to high energies straight away.

Such haste may be wise, for rumours are circulating that physicists working at the Tevatron, which is based at Fermilab and is currently the world's most powerful collider, have been seeing hints of the Higgs boson. Finding it would virtually guarantee the discoverer a Nobel prize—shared jointly, no doubt, with Dr Higgs. Hence the rush, as hundreds of physicists head down the rabbit hole, seeking their own adventures in Wonderland.

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Animal behaviour

Ain't misbehaving

Jun 28th 2007
From The Economist print edition

Adultery yields benefits to females as well as males

FROM an evolutionary perspective, monogamy looks good for females and bad for males. For mothers, it means devotion as dad is going to be around to help look after the kids. For fathers it is more of a prison sentence, because it restricts a male's ability to inseminate lots of females at relatively low cost. In most circumstances, unless the young are likely to die without paternal support, a male has little incentive to stay with an individual female when he has so many other females to breed with.

That, at least, was the conventional wisdom until fairly recently. But modern genetic techniques have shown that in many species females in apparently monogamous relationships often produce families that have more than one father. To explain this, biologists have theorised that these females are mating with males who are genetically superior to their regular mates, thus getting the benefit of parental assistance from a cuckold and good genes from a Lothario.

Proving that, though, is a lengthy process. And it is only now that Aurélie Cohas and her colleagues at the University of Lyon, in France, seem to have done so. Their paper in July's edition of the *Journal of Animal Ecology* shows that for marmots, at least, a bit on the side can help a female's evolutionary chances no end.

The marmots in question live in the Grande Sassière Nature Reserve in the French Alps. For 12 years, Dr Cohas's team trapped them, sexed them, aged them, tagged them with radio transponders and then tracked them to see what they got up to, and with whom. She noted all breeding behaviour and recorded all births. Most pertinently, she identified which offspring were the result of monogamous relationships and which the result of cheating. She then studied those offspring, to see how they fared.

What she found was that young born as a result of adultery were 30% more likely to survive for at least two years, and thus have a decent chance of breeding themselves, than those fathered by a female's permanent male partner. That does, however, raise the question of what the correspondent males are providing to generate this advantage.

Marmots live in family groups, with breeding restricted to a dominant male and a dominant female. Young marmots—males in particular—have a choice when they reach adulthood. They can hang around and hope to take over, or they can leave and become wanderers. Dr Cohas's genetic analyses have shown that it is wanderers, rather than nest mates or neighbours, that females play away with. Wanderers have one clear advantage. Nest mates and neighbours are likely to be relatives. Indeed, marmot social structure actively encourages inbreeding. Wanderers, by contrast, bring fresh genes.

The benefit of outbreeding might be explanation enough for the vigour of their offspring. But it is also possible that wanderers have other advantages. To survive as a lone marmot, you have to be tough. The mere fact of wandering and surviving might therefore be a good indication of genetic fitness.

Whichever is the case, in marmots the idea that a little of what you fancy does you good clearly applies to both sexes. Whether there are any lessons in this for human adulterers remains to be seen.

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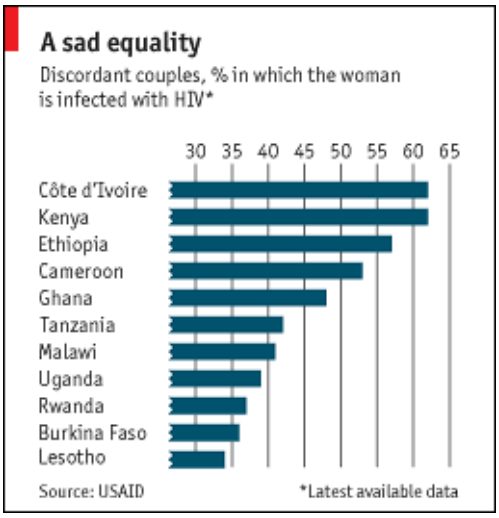
AIDS

The not-so-fair sex

Jun 28th 2007 | KIGALI, RWANDA
From The Economist print edition

Women may be more responsible for spreading HIV than has been suspected

Get article background



IN AIDS epidemiology, one orthodoxy—particularly in Africa, where things are at their worst—is that the main route of transmission is male promiscuity. Of course, in this most political of diseases, political correctness is *de rigueur*, so it is not put quite like that. But the assumption is that men give it to women. Men give it to other men. And to the extent that women give it to men, it is because they have acquired it in the first place in unequal partnerships, such as prostitution, based on male power or male patronage.

There is a lot of truth to this, of course. But perhaps not quite as much as orthodoxy would have it. For work by Vinod Mishra of Macro International, a research firm under contract to the American government, suggests women are not always the innocent vessels that HIV epidemiology takes them for. And that, in turn, means the models that epidemiology relies on may be wrong.

Dr Mishra presented his findings at the HIV/AIDS Implementers' Meeting held last week in Kigali. He had examined medical and demographic surveys from 11 African countries in order to extract data on what are known as discordant couples. In the field of AIDS research, a couple is deemed discordant when one partner is infected with HIV whereas the other is not.

The orthodox view would have predicted that when a couple is discordant, it is more often the man than the woman who is infected. In seven countries this did indeed turn out to be so. In the other four, however, it did not. Côte d'Ivoire and Kenya led, with 62% of discordant couples being female-positive in both countries. And even in Lesotho, where the female-positive discordancy rate was lowest, it was still 34%.

That is a surprise, but might be explained by women having been infected before they settled down. However, in a significant number of cases of female-positive discordancy, that settling down had taken place ten or more years in the past. In these cases it is hard to conceive of any explanation other than infidelity on the part of the woman—a hypothesis supported by the observation that female-positive discordancy is more common in polygamous marriages, where a wife is competing for attention from her husband, than in monogamous ones.

The reason this matters is that, hitherto, policies designed to curb the spread of AIDS by curbing infidelity have relied on surveys that asked people about their behaviour. In these surveys, married and cohabiting women (Dr Mishra did not distinguish between the two) generally claim to be faithful, whereas many men admit to adultery. Campaigns intended to change behaviour have thus been aimed mainly at the men.

That now looks naive. It probably always was. People are notoriously untruthful about their sex lives. Men, for instance, routinely claim in surveys conducted all over the world to have slept with more women than vice versa—an observation that a moment's thought shows is impossible. That should probably have sparked scepticism in the past. Nevertheless, for AIDS policymakers, a little more heterodoxy, and a little more realism, may now be on the cards.

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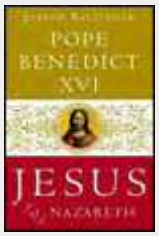
Religion

An author and his subject

Jun 28th 2007
From The Economist print edition

Islam and Christianity may come together in music but the pope, in his book on Jesus, draws one clear dividing line

Jesus of Nazareth
By Pope Benedict XVI



Doubleday; 384 pages; $24.95.
Bloomsbury; £14.99

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ACT

Get article background

THIS is an unusual moment in religious history. In late June, even as Muslims in Pakistan were expressing outrage over the knighthood that Queen Elizabeth is to confer on the “blasphemous” author Salman Rushdie, respected representatives of the Christian Western world were acknowledging the power and beauty of Islamic spirituality.

Westminster Cathedral, Britain's chief place of Roman Catholic worship, offered the shimmering mosaics of its quasi-Byzantine interior as the setting for “The Beautiful Names”, a new composition by Sir John Tavener. The 99 names of God, taken from the Koran, were sung in Arabic and the inspiring, guttural sounds of the language had been diligently mastered by English singers more used to Bach or Handel. The work had been commissioned by Prince Charles, who will one day succeed his mother as head of the Anglican church but cherishes a deep interest in Islam.

On the pavement outside the cathedral, a few Catholics staged a peaceful protest, arguing that because

Islam rejected basic Christian doctrines—such as the Trinity and the divinity of Christ—it had no place in a church. But most of the British establishment seemed to be inside, enjoying the singing. The cathedral authorities insisted that what had taken place was an artistic performance, not an act of worship.

The Catholics' ultimate boss, Pope Benedict, is less flexible. He may feel that because we live in an age when acts of religious accommodation are possible—and, for the sake of world peace, necessary—it is more important than ever to draw doctrinal lines in the sand. In his recently published book “Jesus of Nazareth”, he seems to be saying that “much as we respect one another and accept one another's right to exist, there are important things on which we cannot agree.”

The pope's elegantly, almost tenderly written essay on the founder of his faith is less obviously polemical in tone than his lecture in Germany last September. This outraged Muslim opinion by quoting a Byzantine emperor who had called Islam irrational and violent (the pope later apologised for the offence his remarks had caused but stopped short of withdrawing them). Yet his book remains uncompromising in its insistence on the divinity of Jesus Christ, and hence in its rejection of arguments to the contrary put forward by liberal Christians, or indeed by Muslims and Jews.

Pope Benedict takes issue with a powerful body of conventional wisdom among revisionist scholars of the New Testament. This school starts by making an undeniable point: the contrast in tone between the “synoptic” gospels of Matthew, Mark and Luke—which emphasise the story of Jesus's life as a teacher and healer—and the mystical language of John's gospel (as well as many of the Pauline epistles) which meditate on the divinity of Christ rather than the particular things he did or said. Some modern readings of the New Testament go on to argue that “the historical Jesus” of the first three gospels is not really portrayed as divine at all; and that the divinity of Christ, which is so emphasised by John and Paul, represents a later doctrine that was artificially bolted on to the basic story of Jesus's life.

The pope will have none of this. He insists that the divinity of Christ is very much present in the first three gospels, and that the gospel of John, for all its mysticism, does contain a reliable first-hand historical account of the life of Jesus. In making the first half of this case, he finds himself going head to head—with perfect courtesy, it should be said—with some Jewish critiques of the New Testament.

Whatever Jesus was, the pope argues, he was not simply a free-thinking rabbi who told people to lighten up and ignore the finer points of the Mosaic law. On the contrary, he saw the law of Moses as God-given and supremely important—and it was only because of his own divinity that he had the right to reinterpret that law. In other words, the teachings of Jesus and his divinity are inseparable. That means there is no avoiding a hard argument with those who deny his divinity: either he was the Son of God, and entitled to remake God's law, or he was an impostor.

What emerges from the pope's style of argument is a profound distrust of liberalism and watering-down of any kind. He has no time for the suggestion that Jesus was merely a good human being who offered an interesting new interpretation of Jewish teaching that had become excessively rigid or chauvinist. He respects tough-minded Jews, who do not believe that Jesus was the Messiah, more than woolly conciliators from any side.

Oddly enough Sir John Tavener, the builder of religious bridges through music, says something similar. He has been influenced by a school of thought which maintains that all rigorously followed religious traditions somehow converge at the “summit” of human experience, whatever disagreements may exist lower down. So Sir John admires the traditionalism and rigour of Pope Benedict—just as he admires the traditionalism and rigour of the equivalent schools of Islam and Judaism.

Fine—but how far is it really possible for people who disagree about a matter to which they ascribe supreme importance to admire one another's integrity and rigour? That question may be easier to answer in music than it is in prose.

Jesus of Nazareth.
By Pope Benedict XVI .
Doubleday; 384 pages; $24.95.
Bloomsbury; £14.99

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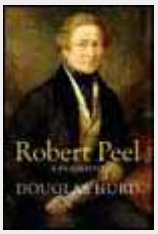
Robert Peel

Father of globalisation

Jun 28th 2007
From The Economist print edition

A TOWERING figure in the history of the British Conservative Party, Sir Robert Peel is regarded by many as the first modern Tory prime minister. His victory in the 1841 general election was the first occasion on which a government was brought down by the votes of the British electorate. He presided over the foundation of the structure of the modern party and, in 1834, launched the first national election manifesto in British history.

Robert Peel: A Biography
By Douglas Hurd



Weidenfeld & Nicolson; 448 pages; £25

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Douglas Hurd's fascinating, eminently readable biography of Peel stands in a long tradition of British politicians writing about politicians, from Lord Rosebery on Lord Randolph Churchill and Roy Jenkins on Herbert Asquith to William Hague on William Pitt the Younger. Lord Hurd's narrative is larded with observations drawn from his own political career (which included stints as home and foreign secretary). The reader is offered many an insight—on Ireland, the ebb and flow of parliamentary debate, the nature of the Tory right wing, the business of government. Lord Hurd obtrudes himself into his story to a far greater extent than would an academic biographer, but this enhances its interest by revealing in passing much about the author's views and experience.

Lord Hurd regards the development of the Conservative Party as a continuum—in marked contrast to New Labour's avowed contempt for history. Peel and the party's current leader, David Cameron, are indissolubly linked by Disraeli, Salisbury, Churchill, Macmillan and Thatcher. Indeed, the recipe that the Conservative Party adopted in 2005 to reverse its defeat in 1997 was based on Peel's recipe for reversing his party's defeat in 1832. Peel, who died in 1850, emerges in Lord Hurd's hands from his early Victorian chrysalis into a much brighter, more relevant figure.

Politicians who change their minds on matters of policy tend to be stigmatised as opportunists devoid of principle. This was as true in the 19th century as it is today. But Peel's career is a fine example of the benefits that accrue from allowing politicians a genuine change of heart.

Peel changed his mind on two of the biggest, most divisive issues of his day: Catholic emancipation (the attempt to obtain full political and civil rights for British and Irish Roman Catholics) and the repeal of the Corn Laws (which protected home-grown grain). His support for emancipation alienated many of the more traditional Anglican Tories, while his espousal of free trade split the party and ended his own political career. Peel saw both reforms as unavoidable and in the national interest. Lord Hurd carefully charts the road he took to conversion; he was a politician who spurned rhetoric and tried to avoid prejudice, preferring the solid virtues of fact and evidence.

He was a bundle of contradictions. His friend, the painter Benjamin Haydon, wrote that Peel “passes life in a perpetual torture of opposite appetites”. He was a reformer who did much to mitigate the notorious harshness of the criminal law and to improve prison conditions, yet he spoke against the Reform Act which was passed by the Whig government in 1832, radically altering electoral representation.

A rich man who built himself two large houses and lived in splendid style, he was deeply moved by the plight of the industrial and agrarian working classes. He worked extremely hard yet retained his outside interests, notably collecting art, shooting and playing the squire on his country estate.

Peel's record in the grind of government was one of solid achievement. Although he may now be best remembered as the founder of the Metropolitan Police (London's police force), his most important legacy is his championing of free trade. Adopting the motto “Advance, not recede”, he recognised the need to lower the barriers to trade and he encouraged others to do likewise.

In his far-sighted stance are the first stirrings of globalisation, the start of the spread of general prosperity based on free trade. Later generations have refined the model but it was Peel “who held the torch and pointed the way”.

Robert Peel: A Biography.
By Douglas Hurd.
Weidenfeld & Nicolson; 448 pages; £25

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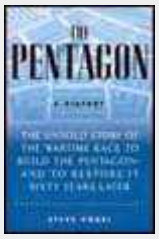
Building the Pentagon

At the double

Jun 28th 2007
From The Economist print edition

THE saga of the construction of the Pentagon, skilfully recounted by Steve Vogel, a military reporter on the *Washington Post*, is as enthralling as it is improbable. One Thursday evening, July 17th 1941, Brigadier-General Brehon Somervell, on his own initiative, assembled a small group of officers from the army's construction division. He told them that they were to build a single headquarters to house the entire war department, then scattered over 23 sites. It would be in Virginia and hold 40,000 people in four air-conditioned storeys. Somervell ordered that the general layout, basic design plans and architectural perspectives for the building be on his desk by 9am on Monday.

The Pentagon: A History
By Steve Vogel



Random House; 656 pages; $32.95

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Guided by the odd shape of Arlington Farm, the plot of land at the foot of Arlington cemetery on which they hoped to build, the planners sketched a skewed five-sided structure “curiously reminiscent of an old fortress: a pentagon”. On Tuesday July 22nd the secretary of war and the army chief of staff gave their approval. At a cabinet meeting two days later President Franklin Roosevelt gave his consent. The plan went through the House of Representatives the same day. The Senate then followed on August 14th.

There was considerable discussion of what might be done with the building after the war was won when the army, obviously, would no longer require that much office space. Roosevelt's idea was to convert it to an archive. To fulfil what now seems a wildly optimistic expectation, the president required that the floors be made strong enough to hold heavy filing cabinets. Under these instructions, they were designed to support twice the normal load. This extravagance was rewarded on September 11th 2001, when the Pentagon largely withstood a Boeing 757 ploughing into its first floor at almost 530 miles (850km) an hour.

The president also changed the site of the building. He decided that to preserve the view of monumental Washington from Arlington cemetery the Pentagon would be constructed in the part of Arlington where it stands now. There was no time to change substantially the design of the building but its five sides were made equal in length.

Selective honesty

A presidential intervention on aesthetic grounds might not happen these days. But Somervell's concealment from Congress of the expanding size and cost of the project is all too familiar. A press release described “a three-storey building with basement”, but the basement was above ground. No mention was made of the planned sub-basement or the sub-sub-basement. After Somervell confessed to a fourth storey—and a large portion of the building had been roofed—he decided on a full fifth floor. Characteristically it was described in documents submitted to Congress as “Fourth floor—intermediate”. Costs were simply omitted—and eventually ballooned to well over twice the original appropriation.

The contract, signed in September 1941, required that at least 500,000 square feet (46,500 square metres) of building be ready for occupancy no later than May 1st. On that date, 600,000 square feet were available and several hundred employees from the Ordnance Department were at their desks working. Construction continued, often in advance of design plans.

When the Pentagon was completed in January 1943, the world's largest office building was “four times the size of the British War Office in Whitehall, the German Kriegsministerium in Berlin and the Japanese general staff headquarters building in Tokyo combined” (though when peace came about the War Department was still scattered over 30 buildings). It was one of the greatest engineering feats of the

20th century—driven by the intelligence and willpower of larger-than-life figures prepared to cut corners and demand the impossible. Mr Vogel has brought to our notice a thrilling achievement.

The Pentagon: A History.
By Steve Vogel.
Random House; 656 pages; $32.95

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Intervention and peacekeeping

Paddy's passions

Jun 28th 2007
From The Economist print edition

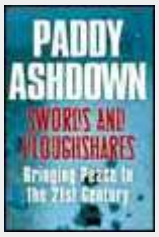
Get article background

FEW people are better qualified to write about muscular international intervention than muscular Paddy Ashdown. A former soldier, diplomat and party leader (who last week turned down Gordon Brown's offer of a cabinet seat), Lord Ashdown ruled Bosnia and its 3.9m people from 2002 to 2006 on behalf of the world.

He took over a mess. Western military intervention had forced all parties to the negotiating table. Arm-twisting at Dayton had produced a deal that stopped the fighting. But Bosnia itself was barely functioning. It had post-communism's typical ills (corruption, incompetence, organised crime and over-mighty spooks) plus the vicious ethnic distrust and physical ruin caused by the war and the baroque bureaucracy imposed by the peace deal.

Lord Ashdown did a good job. He shored up his shaky position by corralling all the international outfits into a council that met weekly to work out a joint position. He used his powers as proconsul to overrule local tyrants, nitwits and crooks. The economy grew, corruption fell, freedoms flourished and some national institutions took shape. Bosnia is still a mess, but a less bad one. With luck, it may join the European Union eventually.

Swords and Ploughshares: Bringing Peace to the 21st Century
By Paddy Ashdown



Weidenfeld & Nicolson; 352 pages; £20

Buy it at Amazon.co.uk

So his book on the ethics and practice of war-ending, peacekeeping, nation-building and international do-goodery has plenty to recommend it. Amid a continuing bloody disaster in Iraq and a looming one in Afghanistan, it is easy to forget that Western intervention elsewhere has been less disastrous. In some bits of ex-Yugoslavia it was not only right (if belated) but, broadly, successful.

Warmongers and peacemakers should read at least the pithy summaries at the end of each of Lord Ashdown's chapters before they start on their next adventure. Don't separate military strategy from plans for the aftermath. Conflicts don't end when the fighting finishes. The “golden hours” after a military victory are crucial. Keep order—by martial law if necessary—otherwise nothing will work. Then get the economy going. Accept that bad people will hold powerful positions for some time. Elections should come once everything is working. Held too early, they spell disaster.

Many readers, however, may find the book frustrating. Lord Ashdown doles out his first-hand experiences in Bosnia grudgingly; presumably he is saving the best stories for another book. His practical advice is mixed with doses of preachiness. The brisk tones of the former special-forces captain sit oddly with woolly clichés, perhaps picked up during his two decades in Britain's third party, the Liberal Democrats. Tiresome spelling errors undermine his authoritative tone: the ex-Nazi who became president of Germany was Kurt Kiesinger, not Keisinger; Iran's president's name is not Ahemdinijad.

But the main lesson is a valuable one, well delivered. Outside intervention is morally justifiable; it can end conflicts and rebuild countries. So far it has been done pretty poorly, sometimes outrageously badly as in Iraq. That disappoints Lord Ashdown. But it does not dismay him.

Swords and Ploughshares: Bringing Peace to the 21st Century
By Paddy Ashdown.
Weidenfeld & Nicolson; 352 pages; £20

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Museums in Sarajevo

Princip's footsteps

Jun 28th 2007
From The Economist print edition

Bosnia's memorials reflect its changes in fortune

SARAJEVO has always been in several minds about how to mark the street corner where, 93 years ago this week, Archduke Franz Ferdinand, the heir to the Austro-Hungarian throne, and his wife were shot by Gavrilo Princip, a 19-year-old Bosnian Serb: the assassination that led to the first world war. A little museum at the corner, once dedicated to Princip and his fellow plotters, was closed during the 1992-95 Bosnian war. This spring it finally reopened, reborn as the 1878-1918 gallery of the Sarajevo Museum, containing artefacts to do generally with Bosnia's occupation under the Austro-Hungarian empire.

The museum's vicissitudes reflect the city's ambiguous and ever-changing relationship with its own past. In 1917 the Austro-Hungarians erected a giant monument at the assassination site. Nearly two years later it was ripped down by the new Yugoslav authorities—though strangely a large central medallion from the monument, bearing the image of Franz Ferdinand and his wife, survives to this day in the basement of another Sarajevo gallery.

In 1930 a plaque was put up to celebrate Princip. In 1941 it was torn from the wall and given to Hitler for his 52nd birthday. After the second world war, Princip was claimed by the communists. Not only was the museum at the corner opened but the assassin's fateful footsteps were set in the pavement. In 1992 they were destroyed and the museum shut: Princip had to go—Bosnian Muslims and Croats saw him as a Serbian hero. In 2004 a new plaque was unveiled. But it simply states the bare facts of what happened in 1914.

Slowly but surely Sarajevo's other museums are coming back to life and in 2008, if all goes to plan, work will begin on building a new museum of contemporary art, designed by Renzo Piano. In the meantime, commemorating the last war is an ugly contest in Bosnia. War memorials dominate public spaces, lauding the sacrifice of those who died fighting the genocide committed by others—who are remembered on similar memorials a few miles away.

Some Bosnian artists have rebelled against all this soul-searching. In April a sculpture by Nebojsa Seric Soba was unveiled: a huge can of corned beef emblazoned with the European Union flag. It is an exact replica of the tins distributed to Bosnians in aid by the EU during the 1992-95 siege. The plinth notes sarcastically that this is a monument dedicated to the international community by the “grateful citizens” of Sarajevo. Since then, a joker in the city has adapted the can. Now it reads: “Canned Bee”.

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New Orleans jazz

When the saints go marchin' out

Jun 28th 2007
From The Economist print edition

What Hurricane Katrina has done to the musicians from Preservation Hall

BACK in the early 1960s, Dixieland jazz was dying, even in New Orleans. Swing and big-band had calcified into music for the parents; even bebop and hard bop were ceding ground to the unbounded explorations of John Coltrane and others. Dixieland musicians, however, were not dead, just unemployed, and to give them a place to play an art dealer in the French Quarter of New Orleans invited some of them into his gallery, Preservation Hall, to draw in customers and play for tips. Soon more people came for the music than the art, and thus was born the Preservation Hall Jazz Band, the world's premiere Dixieland ambassadors.

AP

Rising above the flood waters

Dixieland did not in fact die; though like most jazz it became, at least outside New Orleans, "classicalised": played in concert halls rather than bars and clubs, to older (and whiter) audiences. It remains an authentic expression of America's most musical city. But whether this will be true for the generation dispersed by the 2005 hurricane that destroyed much of the city is troublingly unclear. On June 19th the jazz band touched down for a rollicking concert in New York: "Our home away from home after Katrina," as Ben Jaffe, the band's director and tuba player said.

Officially, New Orleans's population is half its pre-Katrina level. According to the Renew Our Music Fund, one of several charities helping musicians from New Orleans, of the roughly 5,000 full-time, professional musicians who lived in the city before Katrina, some 3,000 are still displaced, with large concentrations in Houston, Baton Rouge and Tennessee. For any profession in any city this would be tragic; for jazz in New Orleans it is cataclysmic.

Great musicians such as Buddy Bolden, Louis Armstrong and Sidney Bechet did not just happen to find themselves in New Orleans; they were products of the city's unique mixture of American, African, French, Cajun, Spanish and Caribbean influences. These discrete strands cohered into a culture that Mr Jaffe calls "a fragile ecosystem". It may be gone for ever.

In New York Mr Jaffe introduced each band member with a short encomium: it was striking to hear how many came from generations of musicians, how many had been discovered or taught by neighbours or family friends, and then to wonder how dispersed those networks are today. As gigs have become more frequent, musicians have begun trickling back, but many still have mailing addresses elsewhere; the clubs have been rebuilt, but their houses remain ruined. The Soul Rebels Brass Band, a younger ensemble that incorporates funk, R&B and hip-hop into the Dixieland tradition, is now based in Houston. Only two of the Dirty Dozen Brass Band's eight members have returned to the Gentilly neighbourhood, where most of the band lived before the hurricane.

And two years after the hurricane, donor fatigue is setting in. The New Orleans Musicians' Relief Fund (NOMRF), another organisation that helps displaced musicians, is preparing to release an album for the two-year “anti-versary” in August. The album will be called “Redefine 8/29”, referring to the day New Orleans was evacuated. Jeff Beninato, the musician who founded NOMRF, says that the title could not refer directly to the hurricane. “If they hear Katrina, they'll think, ‘I don't want to hear that; that's old news.’”

But spare a thought for that most iconic of New Orleans institutions, the funeral with music. A brass band playing sombre dirges leads the mourners and the body tearfully through the streets, from church to cemetery. The body goes into the ground, and the tone changes: the music becomes upbeat, and the mourners turn to revellers, celebrating the life of the departed. Neither Dixieland nor New Orleans is yet a corpse, of course, but nowhere else is quite as adept at wringing joy from tragedy.

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Imre Friedmann

Jun 28th 2007
From The Economist print edition

Imre Friedmann, an extreme microbiologist, died on June 11th, aged 85

Dale T Andersen

LIFE stands no chance at all on the surface of the planet Mars. Fields of reddish oxydised rocks stretch out to the horizon. Carbon dioxide fills the atmosphere, and ultra-violet radiation burns through it. Deep cold and dryness reign everywhere. There has probably been water, for the poles have ice caps and the ground shows channels, gullies and the shifting shoreline of what may once have been an ocean. But water, in itself, is not a proof of life.

So science says. Human curiosity says otherwise. The lines on Mars are surely canals; the dark patches may well be forests; random flashes of light suggest volcanic activity. Move on a notch, and there are little green men, glowing slightly and with their eyes out on stalks, peopling the scene. Or there are far more terrifying creatures, “intellects vast and cool and unsympathetic” as H.G. Wells described them, with grey tentacles and slobbering mouths, hammering together their metal war machines and howling with each death-flash of their Heat-Rays, “Aloo! Aloo!”

Imre Friedmann's version of life on Mars was less noisy but, to him, no less exciting. It lay inside a squarish grey lump of rock known as ALH 84001, a meteorite picked up in 1984 in the Allen Hills of Antarctica. Traces of gas inside it seemed to prove that it came from Mars. And there too, like a microscopic “string of pearls” as Mr Friedmann described it, were flexible chains of crystals that could only have formed by some organic process. They seemed to be the fossilised internal “compasses” of magnetotactic bacteria, similar to kinds that still exist on Earth. And since such bacteria need oxygen, their presence suggested that photosynthesising organisms must once have lived on Mars too.

This discovery, announced in 1996, was the apogee of Mr Friedmann's long search for life in the most daunting places possible. The organisms he found were nothing much to see. They lay under the stony floor of deserts like the Negev, the Gobi and the Atacama, or in the dry valleys of the Antarctic. He called them “cryptoendoliths”, hiders-in-rocks. Most of them were cyanobacteria, familiarly known as blue-green algae, clinging precariously to life in the most extreme conditions of heat, cold, dryness or salinity.

For years the scientific world was indifferent to Mr Friedmann's studies of these organisms. Fame suddenly engulfed him in 1978, not long after the first *Viking* landing on Mars, when NASA had disappointingly concluded that the planet's soil was sterile. Some NASA scientists recalled then that, two years before, Mr Friedmann (with his wife Roseli Ocampo, also a microbiologist) had published a paper on bacteria surviving in terrain almost as hostile as Mars; and the dead rocks began to suggest a different story.

Mr Friedmann himself always felt a peculiar tenderness for his cryptoendoliths: “always hungry, always

too cold, in this grey zone". "In human terms", he said, "you could compare them to the most miserably living generations of pariahs in India. They are born, they live, and they die in the gutter." Like pariahs; or like him when, as a Jew growing up in Budapest, he was debarred from university, forced into a labour camp, driven into a life of hiding from both Germans and Russians bent on killing him, as though he was the most contemptible form of life.

Seaweed in the desert

His enthusiasm for science had started in boyhood and in his mother's kitchen; but his taste for extreme microbiology began in the 1950s, at Hebrew University in Jerusalem. He had gone there, a refugee, to restart his academic career. As a student of seaweed, he had the "outlandish" idea that he might find single-celled versions of seaweed in the desert; and he did indeed find, under the limestone surface of the Negev, a greenish layer like a copper compound that turned out to be algae, alive.

When he moved to Florida State University and when, with NASA's interest, money began to come in, he travelled frequently in search of more. Well into old age he could be spotted, in bright red parka and with frozen beard, lying full-length on the Antarctic sandstone to snap some tiny life-containing fissure in the rocks. Or he could be seen in the Atacama, gently attaching sensors to rocks as if they were living bodies, so that his data boxes could record for seven years the least intimation of something happening inside them.

Of course, any such movement on Mars had long since ceased. About 3 billion years ago, by the best estimates, life had died out there. But Mr Friedmann was fascinated by the thought that Mars might well have been warm, wet and biologically pulsing before Earth was. This provided another data point from which to explore the origins of life. It was possible, too, that life had originally come to Earth from Mars, since it was much easier to make the journey that way than in reverse, and that it had come in the form of bacteria locked up in meteorites like ALH 84001.

Almost as a dare, Mr Friedmann suggested that future voyagers might "terraform" Mars by reintroducing as "pioneer organisms" the cyanobacteria he had discovered. Like the Martian dreams of most Earthlings, it seemed beyond all bounds of probability. But Mr Friedmann's plucky little organisms, life at its most resistant, could never be counted out of anything.

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Overview

Jun 28th 2007
From The Economist print edition

Amid new concerns about subprime mortgages, America's **housing market** weakened again last month. Sales of existing homes edged down by 0.3% in May, leaving them 10.3% lower than in May 2006. The median home price fell by 2.1% compared with a year earlier. Sales of new homes fell by 1.6% in May and were 15.8% below their levels in May 2006.

In **Germany** the Ifo business-climate index fell to 107.0 from 108.6 in May. In **France**, by contrast, the INSEE barometer of business confidence rose from 108 to 110 in June.

In **Japan** retail sales were 0.1% higher in May than a year earlier, the first annual increase in sales for eight months.

Norway's central bank raised its key interest rate from 4.25% to 4.5%, the second increase in as many months. The bank suggested further rate rises were likely in the coming months.

In **Poland** the central bank raised its key interest rate by 0.25 percentage points, to 4.5%. Its monetary-policy council said the increase was warranted as there was a greater chance of inflation rising above the 2.5% target than staying below it.

Hungary's central bank trimmed its key rate from 8% to 7.75%, the first reduction since September 2005. The country's monetary council judged that inflation had passed its peak, but remained cautious about the possibility of further interest-rate cuts.

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Output, prices and jobs

Jun 28th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.9 Q1	+0.6	+2.0	+2.7	+1.6 May	+2.7 May	+4.2	+2.5	4.5 May
Japan	+2.6 Q1	+3.3	+2.3	+2.3	+3.7 May	nil Apr	–0.1	nil	3.8 Apr
China	+11.1 Q1	na	+10.3	+9.7	+18.1 May	+3.4 May	+1.4	+2.8	9.5 2006
Britain	+2.9 Q1	+2.9	+2.7	+2.5	+0.4 Apr	+2.5 May**	+2.2	+2.4	5.5 Apr††
Canada	+2.0 Q1	+3.7	+2.4	+2.7	–0.9 Mar	+2.2 May	+2.8	+2.0	6.1 May
Euro area	+3.0 Q1	+2.4	+2.6	+2.2	+2.8 Apr	+1.9 May	+2.5	+1.9	7.1 Apr
Austria	+3.5 Q1	+3.6	+2.9	+2.6	+6.8 Mar	+2.1 May	+1.7	+1.6	4.4 May
Belgium	+2.9 Q1	+2.9	+2.5	+2.3	+4.6 Apr	+1.3 May	+2.2	+1.8	10.7 May‡‡
France	+2.1 Q1	+2.4	+2.1	+2.2	+1.7 Apr	+1.1 May	+2.1	+1.4	8.1 May
Germany	+3.6 Q1	+2.1	+2.7	+2.3	+3.7 Apr	+1.9 May	+1.9	+1.9	9.2 May
Greece	+4.6 Q1	na	+3.3§	+3.2§	+0.2 Apr	+2.6 May	+3.1	+2.6§	9.5 Mar
Italy	+2.3 Q1	+1.1	+2.0	+1.7	+0.8 Apr	+1.6 May	+2.2	+1.9	6.2 Q1
Netherlands	+2.5 Q1	+2.3	+2.6	+2.5	+5.8 Apr	+1.8 May	+1.7	+1.7	4.6 May††
Spain	+4.1 Q1	+4.6	+3.6	+2.8	+6.5 Apr	+2.3 May	+4.1	+2.6	8.2 Apr
Czech Republic	+6.1 Q1	+6.1	+5.3	+4.9	+14.0 Apr	+2.4 May	+3.1	+2.6	6.4 May
Denmark	+1.8 Q1	+1.9	+2.2	+2.2	+1.6 Apr	+1.8 May	+2.0	+1.8	3.7 Apr
Hungary	+2.7 Q1	+2.4	+2.6	+3.1	+10.6 Apr	+8.5 May	+2.8	+6.8	7.3 May††
Norway	+2.8 Q1	+2.9	+2.7§	+2.5§	+6.1 Apr	+0.3 May	+2.3	+0.8§	2.7 Apr††
Poland	+7.4 Q1	na	+6.0	+5.3	+8.1 May	+2.3 May	+1.2	+2.2	13.0 May‡‡
Russia	+7.9 Q1	na	+6.7	+6.4	+6.7 May	+7.6 May	+9.5	+8.2	6.9 May‡‡
Sweden	+3.0 Q1	+2.6	+3.7	+3.1	+3.6 Apr	+1.7 May	+1.6	+1.7	3.9 May††
Switzerland	+2.4 Q1	+3.2	+2.2	+2.1	+7.3 Q1	+0.5 May	+1.4	+0.6	2.7 May‡‡
Turkey	+5.2 Q4	na	+4.6	+5.7	+1.4 Apr	+9.2 May	+9.9	+8.3	11.4 Q1‡‡
Australia	+3.8 Q1	+6.6	+3.0	+3.2	+3.7 Q4	+2.4 Q1	+3.0	+2.5	4.2 May
Hong Kong	+5.6 Q1	+2.0	+5.3	+4.9	–1.5 Q1	+1.2 May	+2.1	+2.4	4.3 May††
India	+9.1 Q1	na	+8.1	+7.6	+13.6 Apr	+6.7 Apr	+5.0	+5.7	7.6 2006
Indonesia	+6.0 Q1	na	+6.0	+5.8	+11.9 Mar	+6.0 May	+15.6	+6.5	10.3 2005
Malaysia	+5.3 Q1	na	+5.4	+5.6	+0.4 Apr	+1.4 May	+3.9	+2.3	3.0 Q4
Pakistan	+6.6 2006§§	na	+6.8§	+5.9§	+6.8 Sep	+7.4 May	+7.1	+6.3§	na
Singapore	+6.1 Q1	+7.6	+5.5	+5.7	+18.8 Apr	+1.0 May	+1.1	+1.6	2.9 Q1
South Korea	+4.0 Q1	+3.6	+4.3	+4.6	+6.6 May	+2.3 May	+2.3	+2.2	3.4 May
Taiwan	+4.2 Q1	na	+4.2	+4.6	+6.4 May	nil May	+1.6	+1.3	4.0 May
Thailand	+4.3 Q1	+4.9	+4.0	+4.7	+6.7 Apr	+1.9 May	+6.2	+2.5	1.5 Feb
Argentina	+8.0 Q1	+4.1	+7.5	+5.7	+4.0 May	+8.8 May	+11.5	+9.8	9.7 Q1‡‡
Brazil	+4.3 Q1	+3.2	+3.9	+3.7	+6.0 Apr	+3.2 May	+4.2	+3.6	10.1 Apr‡‡
Chile	+5.8 Q1	na	+5.2	+5.1	+3.0 May	+2.9 May	+3.7	+2.6	6.8 Apr††††
Colombia	+8.1 Q1	nil	+5.4	+4.6	+13.3 Apr	+6.2 May	+4.0	+5.1	11.0 Apr‡‡
Mexico	+2.6 Q1	+0.6	+3.2	+3.8	+1.5 Apr	+3.9 May	+3.0	+3.8	3.2 May‡‡
Venezuela	+8.8 Q1	na	+6.6	+3.9	+6.7 Mar	+19.5 May	+10.4	+17.6	8.0 Q2‡‡
Egypt	+7.4 Q1	na	+6.3	+5.6	+10.5 2006	+10.5 May	+5.3	+9.9	9.0 Q4‡‡
Israel	+5.4 Q1	+6.3	+4.7	+4.3	+9.1 Apr	–1.3 May	+3.5	+0.9	7.7 Q1
Saudi Arabia	+3.4 2006§	na	+3.9§	+5.0§	na	+3.0 May	+2.2	+2.7§	na
South Africa	+5.4 Q1	+4.7	+4.8	+4.9	+3.8 Apr	+6.9 May	+3.9	+5.4	25.5 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+9.9 Q1	+9.5	+9.4§	+5.8§	+8.0 Apr	+5.7 May	+4.7	+5.3§	4.7 Apr
Finland	+5.4 Q1	+3.4	+2.7§	+2.5§	–1.4 Apr	+2.4 May	+1.7	+1.4§	6.3 May
Iceland	–0.1 Q1	–3.6	+1.3§	+2.7§	+7.6 2006	+4.0 Jun	+8.0	+5.0§	1.1 May‡‡
Ireland	+5.0 Q4	+0.1	+5.0§	+3.4§	+5.8 Apr	+5.0 May	+3.9	+4.2§	4.5 May
Latvia	+10.7 Q1	na	+9.2§	+7.5§	–0.9 Apr	+8.2 May	+6.6	+7.6§	5.6 May
Lithuania	+8.3 Q1	+6.1	+7.0§	+6.4§	na	+4.8 May	+3.5	+1.9§	5.4 Apr
Luxembourg	+5.0 Q4	+7.0	+4.7§	+5.0§	+1.8 Mar	+1.9 May	+3.1	+2.2§	4.4 Apr‡‡
New Zealand	+2.9 Q4	+5.0	+3.1§	+3.1§	–0.4 Q4	+2.5 Q1	+3.3	+2.2§	3.8 Q1
Peru	+7.3 Apr	na	+6.7	+5.6	+7.7 Mar	+0.9 May	+2.2	+1.1	8.0 May‡‡
Philippines	+6.9 Q1	+10.3	+5.7	+5.8	–7.6 Mar	+2.4 May	+6.9	+3.9	7.4 Q2‡‡
Portugal	+2.1 Q1	+3.2	+1.6§	+2.1§	+3.8 Apr	+2.4 May	+3.8	+2.2	8.4 Q1‡‡
Slovakia	+9.0 Q1	na	+8.0§	+6.0§	+14.9 Apr	+2.3 May	+4.8	+2.5	10.5 Apr
Slovenia	+7.2 Q1	na	+4.6§	+4.1§	+13.1 Apr	+2.9 May	+3.2	+2.7	7.9 Apr‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 4.3% in May. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Jun 28th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Jun 19th	Jun 26th*	% change on one month	% change on one year
Dollar index				
All items	203.5	202.2	+0.2	+19.7
Food	172.0	169.9	+4.4	+25.3
Industrials				
All	244.3	243.9	–3.3	+15.1
Nfa†	163.9	162.4	–1.2	+0.5
Metals	288.1	288.4	–4.0	+20.5
Sterling index				
All items	155.3	153.3	–0.7	+9.2
Euro index				
All items	140.3	138.9	+0.3	+12.0
Gold				
$ per oz	657.35	644.50	–2.0	+8.6
West Texas Intermediate				
$ per barrel	69.08	67.80	+7.2	–5.8

*Provisional †Non-food agriculturals.

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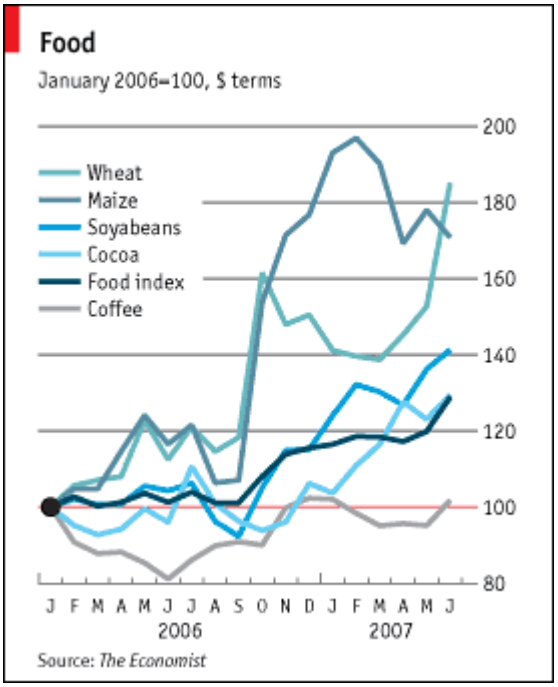
Food

Jun 28th 2007
From The Economist print edition



Led by soaring grain prices, *The Economist*'s dollar food-index has risen to its highest level for more than a decade. Wheat prices are at an 11-year high, and stocks are forecast to fall to a 30-year low by June 2008, despite a recovery in Australia's harvest. Tempted by high prices, American farmers have planted the biggest maize crop since 1944, though a quarter of it will be used to make fuel ethanol. As a result, the soyabean harvest will be smaller and American stocks are forecast to fall by nearly a half in 2007-08. The price of robusta beans, used to make instant coffee, has hit a nine-year high, thanks to a shortage in Vietnam. And drought in Africa has pushed cocoa prices to a four-year high.

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Trade, exchange rates, budget balances and interest rates

Jun 28th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†	Currency units, per $ Jun 27th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−829.9 Apr	−803.4 Q1	−6.2	–	–	−1.4	5.27	5.07
Japan	+92.0 Apr	+186.9 Apr	+4.3	122	116	−4.4	0.63	1.86
China	+216.7 May	+249.9 2006	+8.1	7.62	8.00	−1.3	3.08	4.13
Britain	−158.3 Apr	−80.1 Q4	−3.1	0.50	0.55	−2.8	5.92	5.42
Canada	+46.0 Apr	+18.5 Q1	+1.2	1.07	1.13	0.9	4.42	4.60
Euro area	+8.6 Apr	+8.1 Apr	+0.1	0.74	0.80	−0.8	4.16	4.54
Austria	+0.3 Mar	+10.3 Q4	+2.4	0.74	0.80	−0.8	4.16	4.61
Belgium	+19.5 Apr	+7.8 Dec	+2.0	0.74	0.80	nil	4.22	4.61
France	−34.8 Apr	−32.3 Apr	−1.3	0.74	0.80	−2.9	4.16	4.59
Germany	+227.3 Apr	+167.7 Apr	+4.8	0.74	0.80	0.3	4.16	4.54
Greece	−46.6 Apr	−33.2 Apr	−8.4‡	0.74	0.80	−2.2	4.16	4.73
Italy	−22.4 Apr	−48.4 Apr	−2.1	0.74	0.80	−2.6	4.16	4.76
Netherlands	+43.7 Apr	+16.8 Q1	+8.2	0.74	0.80	0.6	4.16	4.58
Spain	−118.5 Apr	−113.0 Mar	−8.8	0.74	0.80	1.1	4.16	4.61
Czech Republic	+2.6 Apr	−5.7 Apr	−3.8	21.3	22.7	−4.1	2.97	4.57
Denmark	+5.2 Apr	+4.8 Apr	+2.5	5.54	5.95	4.0	4.40	4.60
Hungary	−2.1 Apr	−6.5 Q4	−4.7	184	224	−6.7	7.66	6.60
Norway	+54.1 May	+57.3 Q1	+14.3‡	5.93	6.31	16.8	4.77	5.18
Poland	−7.1 Apr	−8.8 Apr	−2.6	2.82	3.24	−2.3	4.57	5.64
Russia	+129.8 Apr	+85.8 Q1	+5.7	25.8	27.1	2.4	10.00	6.13
Sweden	+19.5 May	+29.8 Q1	+6.6	6.90	7.38	2.2	3.42	4.44
Switzerland	+10.5 May	+106.1 Q4	+15.7	1.23	1.25	0.3	2.54	3.09
Turkey	−53.0 Apr	−31.3 Apr	−7.0	1.33	1.61	−2.7	19.14	6.65§
Australia	−10.8 Apr	−43.8 Q1	−5.3	1.19	1.37	1.4	6.42	6.19
Hong Kong	−18.9 May	+20.6 Q4	+9.8	7.82	7.77	2.7	4.43	4.55
India	−61.3 Apr	−10.0 Q4	−1.8	41.0	46.4	−3.3	7.12	8.45
Indonesia	+41.5 Apr	+9.6 Q4	+2.2	9,133	9,341	−1.6	8.38	6.68§
Malaysia	+28.3 Apr	+25.6 Q4	+13.5	3.48	3.68	−3.7	3.62	5.55§
Pakistan	−13.6 May	−6.8 Q1	−5.7‡	60.5	60.2	−3.8	9.56	7.03§
Singapore	+35.4 May	+38.1 Q1	+23.3	1.54	1.60	0.3	2.55	2.81
South Korea	+16.6 May	+5.2 Apr	+0.2	928	958	0.5	5.03	5.41
Taiwan	+13.7 May	+28.1 Q1	+6.7	32.8	32.7	−2.2	2.60	2.50
Thailand	+7.0 Apr	+8.8 Apr	+2.1	34.6	38.5	−1.9	3.75	4.12
Argentina	+11.3 May	+7.8 Q1	+2.5	3.10	3.09	1.2	9.25	na
Brazil	+47.6 May	+15.1 Apr	+0.8	1.95	2.23	−2.4	11.93	6.16§
Chile	+25.5 May	+7.1 Q1	+1.3	530	549	5.5	5.40	5.67§
Colombia	−1.0 Mar	−2.9 Q4	−2.7	1,982	2,635	−0.9	7.93	6.19§
Mexico	−11.3 May	−5.5 Q1	−1.4	10.9	11.4	−0.2	7.19	7.69
Venezuela	+28.2 Q1	+23.8 Q1	+9.8	2,147	2,634	−4.7	10.15	6.55§
Egypt	−12.6 Q4	+2.7 Q4	+1.5	5.70	5.76	−5.5	6.78	5.60§
Israel	−7.5 May	+8.1 Q1	+3.6	4.27	4.48	−1.0	3.86	4.91
Saudi Arabia	+148.5 2006	+95.4 2006	+21.4‡	3.75	3.75	16.6	5.04	na
South Africa	−9.9 Apr	−16.6 Q1	−6.0	7.19	7.23	0.5	9.80	8.46
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−3.8 Mar	−2.6 Mar	−14.9‡	11.6	12.5	2.7	4.71	na
Finland	+12.3 Apr	+13.9 Apr	+5.7†	0.74	0.80	2.5	4.11	4.59
Iceland	−1.9 Apr	−4.0 Q1	−18.7‡	62.8	76.7	1.8	13.77	na
Ireland	+35.2 Apr	−7.2 Q4	−5.0‡	0.74	0.80	0.5	4.16	4.58
Latvia	−5.8 Apr	−5.4 Apr	−20.0‡	0.52	0.56	nil	7.22	na
Lithuania	−6.0 Apr	−3.7 Apr	−10.3‡	2.57	2.76	−0.5	4.89	na
Luxembourg	−5.3 Mar	+4.4 Q4	na	0.74	0.80	0.3	4.16	na
New Zealand	−3.9 May	+6.2 Q4	−10.3‡	1.32	1.69	3.1	7.05	6.69
Peru	+9.0 Apr	+2.7 Q1	+1.8	3.17	3.27	0.4	4.55	na
Philippines	−3.7 Apr	+5.0 Dec	+3.6	46.6	53.6	−0.7	6.19	na
Portugal	−22.9 Mar	−17.8 Mar	−7.5‡	0.74	0.80	−3.3	4.16	4.72
Slovakia	−2.2 Apr	−3.7 Feb	−4.3‡	25.2	30.5	−2.9	4.13	4.61
Slovenia	−2.2 Apr	−1.3 Mar	−2.0‡	0.74	0.80	−1.2	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Jun 28th 2007
From The Economist print edition

Markets

	Index Jun 27th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,427.7	−0.5	+7.7	+7.7
United States (S&P 500)	1,506.3	−0.4	+6.2	+6.2
United States (NAScomp)	2,605.4	+0.2	+7.9	+7.9
Japan (Nikkei 225)	17,849.3	−2.0	+3.6	+0.8
Japan (Topix)	1,741.1	−2.4	+3.6	+0.8
China (SSEA)	4,280.4	−2.4	+52.1	+55.8
China (SSEB, $ terms)	274.1	−8.6	+105.6	+110.7
Britain (FTSE 100)	6,527.6	−1.8	+4.9	+7.1
Canada (S&P TSX)	13,741.9	−1.7	+6.5	+15.6
Euro area (FTSE Euro 100)	1,384.8	−2.9	+8.3	+10.3
Euro area (DJ STOXX 50)	4,412.1	−2.9	+7.1	+9.1
Austria (ATX)	4,764.0	−3.9	+6.7	+8.7
Belgium (Bel 20)	4,572.9	−2.2	+4.2	+6.1
France (CAC 40)	5,941.7	−2.5	+7.2	+9.2
Germany (DAX)*	7,801.2	−3.6	+18.3	+20.5
Greece (Athex Comp)	4,756.0	−2.9	+8.2	+10.2
Italy (S&P/MIB)	41,439.0	−3.1	nil	+1.9
Netherlands (AEX)	539.6	−2.3	+8.9	+11.0
Spain (Madrid SE)	1,619.7	−2.3	+4.2	+6.1
Czech Republic (PX)	1,834.5	−0.9	+15.5	+13.3
Denmark (OMXCB)	458.7	−2.5	+8.1	+10.3
Hungary (BUX)	28,565.5	+6.7	+15.0	+19.1
Norway (OSEAX)	567.0	−2.6	+12.9	+18.5
Poland (WIG)	65,609.1	+1.0	+30.1	+34.2
Russia (RTS, $ terms)	1,875.2	−2.1	−4.2	−2.4
Sweden (Aff.Gen)	396.2	−2.9	+8.5	+7.6
Switzerland (SMI)	9,025.8	−3.4	+2.7	+2.1
Turkey (ISE)	45,161.8	−2.4	+15.5	+22.8
Australia (All Ord.)	6,216.6	−3.2	+10.1	+17.1
Hong Kong (Hang Seng)	21,705.6	+0.1	+8.7	+8.2
India (BSE)	14,431.1	+0.1	+4.7	+13.0
Indonesia (JSX)	2,125.3	−1.7	+17.7	+15.9
Malaysia (KLSE)	1,357.4	−2.1	+23.8	+25.4
Pakistan (KSE)	13,669.0	+0.8	+36.1	+37.0
Singapore (STI)	3,505.5	−3.4	+17.4	+17.1
South Korea (KOSPI)	1,733.1	−2.8	+20.8	+21.1
Taiwan (TWI)	8,844.2	+1.0	+13.0	+12.3
Thailand (SET)	771.0	−0.8	+13.4	+18.6
Argentina (MERV)	2,227.3	+0.1	+6.5	+5.6
Brazil (BVSP)	54,143.0	+0.2	+21.7	+33.2
Chile (IGPA)	14,898.4	+1.6	+20.4	+20.9
Colombia (IGBC)	10,713.5	+1.2	−4.0	+8.4
Mexico (IPC)	30,804.2	−2.4	+16.5	+16.0
Venezuela (IBC)	39,426.2	−0.3	−24.5	+17.5
Egypt (Hermes)	69,406.4	−2.2	+13.2	+13.6
Israel (TA-100)	1,100.1	−1.4	+19.4	+17.9
Saudi Arabia (Tadawul)	7,011.2	−0.2	−11.6	−11.6
South Africa (JSE AS)	28,285.1	−4.2	+13.5	+11.4
Europe (FTSEurofirst 300)	1,579.5	−2.5	+6.5	+8.5
World, dev'd (MSCI)	1,588.2	−1.4	+7.1	+7.1
Emerging markets (MSCI)	1,045.0	−1.8	+14.5	+14.5
World, all (MSCI)	396.1	−1.5	+7.7	+7.7
World bonds (Citigroup)	655.2	+0.7	−0.5	−0.5
EMBI+ (JPMorgan)	409.5	−0.8	+0.5	+0.5
Hedge funds (HFRX)	1,351.2	−0.9	+5.9	+5.9
Volatility, US (VIX)	15.5	14.7	11.6	(levels)
CDSs, Eur (iTRAXX)†	19.0	+10.5	−11.0	−9.3
CDSs, N Am (CDX)†	35.0	+9.7	+19.3	+19.3
Carbon trading (EU ETS) €	0.08	−20.0	−98.7	−98.7

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

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Foreign direct investment

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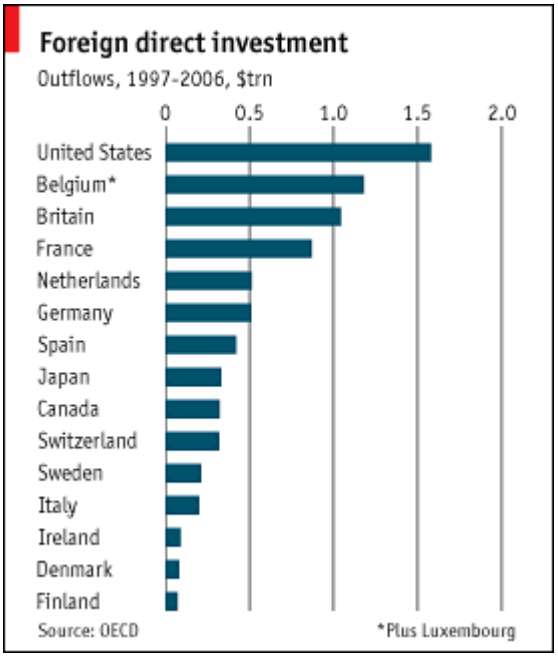

The 30 members of the OECD made foreign direct investments (FDI) worth $1.12 trillion last year, 29% more than in 2005. This was a record year beaten only by 2000. France was the second-biggest investor last year, thanks to a number of big mergers and acquisitions, including Alcatel's purchase of Lucent in America and AXA's takeover of Winterthur, a Swiss insurer. Over the ten years to 2006, the OECD's members have made direct investments worth over $8 trillion outside their borders. America has been the biggest source of money, investing a total of $1.58 trillion. But Belgium and Luxembourg, popular bases for holding companies and special-purpose vehicles, together come second.

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